Securities Industry Trends

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

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CRITIQUING THE SEC STAFF REPORT

HIGHLIGHTS

1. The SEC Staff Report on the Securities Industry in 1978, published in July 1979, represents the SEC's most ambitious and comprehensive analysis of the securities industry to date. It is the first SEC report to utilize the new SEC/SIA firm categories, and it contains a wealth of financial data for each category. In this issue of Trends, key elements of the staff report are discussed and summarized.

2. Although 1978 was a year of record volume and revenues for the industry, profits and securities prices lagged behind. The SEC attributes the industry's failure to achieve record profits in 1978 to a closer link between marginal revenues and marginal costs resulting from negotiated commission rates. The fourth quarter 1978 decline in securities prices seems to be a better explanation.

3. Industry capital has grown more slowly than industry assets, with a resultant increase in leverage. The industry's debt/equity ratio was 14.7 at year-end 1978, as compared to 12.8 one year earlier and 7.2 five years earlier.

4. The report correctly notes the tendency of FOCUS to understate diversification outside the securities business. Revenues unrelated to the securities business are reported on FOCUS as only 2% of the industry's gross revenues. Inspection of the 10-Ks of the largest publicly held firms suggests that the figure may be as high as 8%.

5. The unfixing of commissions, the report states, has not accelerated the trend toward industry concentration. This conclusion is derived from a series of regression equations that are not shown in the report. The SEC staff fails to take account sufficiently of the very poor market conditions experienced in the final two years of fixed rates or of the highly favorable market conditions that prevailed in the first two years of competitive rates.

6. Discount brokers, the SEC estimates, have reached a 4.2% share of retail share volume. Advertising commission prices roughly half the old fixed rate schedule, these firms achieved the highest return in the industry in 1978.

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Introduction

The SEC Staff Report on the Securities Industry in 1978, published in July 1979, represents the most ambitious and comprehensive analysis of the securities industry conducted by the SEC to date. The SEC document reviews the financial experience of the industry in 1978 and discusses those economic variables which seem to have impacted most strongly upon the industry. More importantly, the data base provided in this report is broader than any previously published by the SEC. For the first time, observers of the securities industry can locate in one source much of the financial data covering the various segments of the securities industry.

The data contained in the staff report is particularly helpful in expanding the information on OTC and regional exchange broker/dealers and covers new areas, such as stock exchange specialists. In addition, there is further analysis of trends in concentration and diversification in the industry, and a new classification of firm groups resulting from an SEC/SIA joint effort.

In this issue of Trends, an effort is made to summarize key elements of the staff report and to review conclusions, whether or not they are consistent with SIA's own analysis. Although SIA takes exception to some of the conclusions presented in the report and questions the accuracy, for instance, of the commission rate data, the SEC report provides a great service to the industry. Familiarity with the report's key findings, in our opinion, is essential to all those interested in the health of the securities industry.

Profitability

The staff report begins with a discussion of the economic environment in which the securities industry operated in 1978, concluding that "1978 was a good year but not an outstanding one." The second and third quarters broke all existing volume records on major exchanges, while the fourth quarter saw the return of double-digit inflation, rising interest rates and falling securities prices. Exchange volume and industry revenues were at record levels in 1978, but stock prices and industry profits lagged behind.

The 1978 experience of record revenues that failed to produce record profits is explained by the SEC in terms of the impact of negotiated rates. Due to competition in the pricing of brokerage services, the report explains, marginal revenues for the industry have been brought more nearly into line with marginal costs, lessening the impact on profits of sudden spurts of trading activity. It is suggested that the industry's profit margins -- and, hence, profitability -- have become less volatile since 1975. Both of these conclusions, in SIA's opinion, are questionable.

The report presents a regression equation that explains the industry's profit margin in terms of volume and stock price trends. The equation indicates that the importance of volume as a determinant of profit margins has diminished since 1975, while that of stock price trends has increased. This finding is consistent with the observed rise in the importance of principal activities and the declining importance of agency business. The report fails to note the connection between increased principal activities and business risk. The disappointing profit levels of 1978, also, could be more correctly attributed to the fourth quarter drop in securities prices than to any post-Mayday restructuring of the commission business. Given the industry's greater automation in recent years, there is no reason for incremental costs to be more closely related to incremental revenues today than was true in the past. The only major variable costs are RR compensation and clearance and floor brokerage. If anything, costs are more "fixed" today than in the past.

The greatest revenue increases, the report notes, were in revenue items that cause a parallel increase in expenses -- higher commissions mean higher RR compensation expenses, for instance, and higher margin interest revenues mean higher interest expense. The report compares the industry's 1978 experience with that of 1975, a more profitable year, noting that "the revenue expansion enjoyed by NYSE member firms in 1978 easily surpassed that of the dramatic recovery in 1975." Negotiated commissions were in effect for all but the first four months of 1975, but institutional discounting did not reach present levels in that year. The main difference between 1975 and 1978, however, is that interest rates were falling throughout 1975, while just the reverse was true in 1978. The expense picture for 1978 was dominated by interest expense, incurred to finance both customer margin accounts and securities positions. The degree to which rising margin interest revenues are cancelled by rising interest expense is recognized in the report, but the full impact of rising interest rates on trading and investment profits is not.

The report also spends a considerable amount of time comparing the 1978 financial performance of the industry with its 1977 performance. This is unfortunate because 1977 was a mediocre year for the industry. If the Commission's concern is whether capital will stay committed to the securities business, it is more appropriate to compare the securities industry's rate of return in any one year with what can be earned elsewhere.

An interesting SEC finding, one consistent with SIA's own research, is that larger securities firms do not achieve superior returns. Whether ranked by gross revenues, equity or total capital, the smallest size category achieved the highest median return.

Balance Sheet

The balance sheets of securities firms underwent major changes in 1978. The industry's total assets, at the end of the fourth quarter of 1978, amounted to $53.9 billion, up from $43.6 billion one year earlier and $20.7 billion five years earlier. Most of this asset growth relates to three asset categories -- customer receivables, trading and investment accounts and securities purchased under agreements to resell. This asset growth has not been matched by a corresponding increase in capital, with the result that the industry's debt/equity ratio increased from 7.2 at year-end 1973 to 14.7 five years later. A balance sheet for all NYSE firms dealing with the public is presented below:

UNCONSOLIDATED BALANCE SHEET OF NYSE MEMBER FIRMS
DOING A PUBLIC BUSINESS. YEAR END 1978.
(millions of dollars)

ASSETS	
Cash	$ 984
Receivables from Broker/Dealers and Clearing Corporations	5,109
Receivables from Customers	15,868
Long Positions	15,238
Securities Purchased Under Agreements to Resell	14,018
Exchange Memberships	108
Other Assets	2,577
TOTAL ASSETS	$53,902

LIABILITIES	
Banks Loans Payable:	
Secured by Firm Collateral	$ 4,337
Secured by Customer Collateral	5,123
Securities Sold Under Repurchase Agreements	16,306
Payables to Broker/Dealers and Clearing Organizations	4,676
Payables to Customers	7,202
Short Positions in Securities & Commodities	6,610
Accounts Payable & Accrued Liabilities	4,970
Other Liabilities	288
Subordinated Liabilities	963
Total Liabilities	50,475
Owner's Equity	3,427
TOTAL LIABILITIES & OWNER'S EQUITY	$53,902

Of the three major asset accounts, customer receivables are derived from retail business, involving margin loans, while long positions and securities purchased to resell are more dealer-related. Customer receivables represent less of a new trend than either long positions or repurchase agreements, but it is an important source of revenue both directly, through interest receipts, and indirectly, as a means of stimulating agency business. The industry's commitment to long positions is largely a response to institutional investors' needs for liquidity. It would be helpful if there were a more detailed breakdown of the long positions -- equity, corporate debt, municipals, U.S. government, etc.

Industry assets currently include $14.0 billion of securities purchased under agreements to resell (reverse repos). Reverse repos provide an outlet for temporarily idle funds, entitling the purchaser to a stated rate of interest when the securities are resold.

On the liabilities side, parallel developments have taken place. Securities sold under agreements to repurchase, at $16.3 billion, comprise the largest single liability item. Repurchase agreements are a financing device of institutional dealer firms. Bank loans secured by customers' collateral are used to finance margin loans, while those secured by firm collateral finance proprietary positions. Between year-end 1977 and year-end 1978, bank loans declined from 28% to 19% of the industry's total liabilities.

The increase in leverage has been more pronounced among firms doing an institutional/dealer business. Large investment banking firms were the most leveraged at year-end 1978, with a 26.2 debt/equity ratio. The institutional category was second, with a ratio of 18.8. National full line firms, in contrast, had a ratio of only 12.4, up from 8.0 one year earlier.

Diversification

The industry's earliest attempts to diversify, as the report correctly notes, did not take firms outside traditional securities activities and were responses to the dwindling importance of agency business. SIA agrees that early diversification efforts were demand-pull in nature rather than conscious attempts to offer new products or cultivate new customers. We disagree, however, with the report's conclusion that diversification outside the securities business is insignificant. The recent forays by several publicly owned securities firms into timber and oil exploration, vineyards and real estate do not seem very closely related to traditional securities activities.

The report's appraisal of diversification is derived from FOCUS, which reports revenues unrelated to the securities business amounting to only 2% of the industry's 1978 gross revenues. FOCUS, however, tends to understate diversification, as the staff report acknowledges, by its exclusion of non-securities affiliates. After inspection of the 10-Ks of the largest publicly held securities firms, the SEC staff concluded that non-securities revenues could account for as much as 8% of the 1978 gross revenues of the largest publicly held firms. These non-securities revenues are derived largely from such activities as leasing, insurance, real estate and tax shelters. The largest privately held firms, the report points out, are believed to have undertaken comparable efforts at diversification, although hard data concerning the extent of their activities are not publicly available.

We believe that securities industry diversification, at least that involving the largest firms, has undergone a qualitative change recently. The 8% figure mentioned above is significantly higher than the 2% indicated in FOCUS for non-securities revenues, and the movement into new business lines seems to be gathering strength. Over the longer term, the securities industry will be unable to retain invested capital if it continues to provide an unacceptably low risk-adjusted rate of return. For the large publicly held firms, capital could be expected to flow out of the brokerage/investment banking business into non-securities affiliates earning more acceptable returns. For the smaller, closely-held firms, withdrawal of principals' capital would be the more likely development.

Concentration

This report includes a description of regression equations that attempted to measure the causal relationship between the unfixing of commission rates and the trend toward increased concentration in the industry. On the strength of the regression equations, the staff concluded that the unfixing of commissions has had no significant impact upon the trend towards concentration. It is unfortunate that the regression equations themselves are shown nowhere in the report.

Although the regression equations are not shown, certain facts concerning them are given. Quarterly data for the period 1972-1978 are used, and concentration is defined as the largest ten firms' market share in commissions, underwriting revenues, gross revenues and equity capital. Our first and probably strongest objection to the analysis is the short time period over which concentration is measured, only 13 quarters under fixed rates and 15 quarters under competitive rates. This is too short a period from which to derive any meaningful conclusion.

In our opinion, the analysis fails to take account sufficiently of the extremely poor market conditions that prevailed in the final two years of fixed rates or of the highly favorable market conditions the industry experienced in the first two years of negotiated rates. What appears to be a simple trend over time could be something very different if seen in the light of market conditions. The report states that an effort was made to filter out the effects of market conditions as measured by share volume, net income before taxes or profit margins. Because the equations are not shown, however, we remain skeptical.

Two further objections involve the concentration measure selected and the lack of a lag variable. SIA's research indicates that greater consolidation has taken place among the second fifteen than among the largest ten firms. For this reason, the market share of the largest twenty-five firms would be a more useful measure. As regards the time lag variable, it seems clear that all the economic consequences of a single year do not become visible during that year. For example, much of the consolidation that took place during 1972, a relatively prosperous year, can undoubtedly be attributed to the earlier paperwork crisis and bear market of 1969-70 from which the industry was recovering.

It is regrettable that the report does not more thoroughly document a finding of such great importance to the industry. It is interesting that a footnote on page 57, speaking of institutional research houses, does observe that "the rapid decimation of their ranks immediately after the unfixing strongly suggests that they greatly underestimated the impact [of negotiated rates]."

Commission Rates

The post-Mayday restructuring of commissions, the report states, was substantially completed by January 1978. Except for slight increases during the second and third quarters, a period of strained capacity, commission charges did not change significantly throughout 1978. The report's findings are based upon the SEC's monthly survey of commission charges which covers an estimated 50% of total share volume on all exchanges. There is a statement in the report that on orders below 200 shares individuals now pay about 5.4%, on average, more than the old fixed rate. Between 200 and 999 shares, the SEC finds that rates are virtually the same for individuals as they were in April 1975. The SEC explains that the observed increases for small orders are generally much less than the increase implied by comparing quoted rates today with the old fixed rates because quoted rates may actually be rigid only for small, inactive or new accounts. While most retail accounts may be small, inactive or new, most of the retail business comes from large, active and established accounts.

We think this involves some heroic explanations. We continue to believe that a good deal of the data being received by the SEC does not adequately distinguish between individual and institutional orders, particularly on small orders. This was a constant problem with the New York Stock Exchange's Public Transaction Survey. We agree that there may be considerable differences between the quoted rates and the rates actually paid by large and active retail accounts. Nevertheless, all the surveys reported in the trade press and the newspapers agree that more investors are paying higher rates today than under fixed rates, and the increase is undoubtedly greater than 5.4% for orders under 200 shares. Our criticism of the SEC findings has nothing to do with value judgments. Rather, we feel it very important, as a matter of record, that the impact of negotiated rates on individual orders be accurately reported. Obviously, we believe the increases are greater than those reflected in the SEC report.

Specialists

For the first time, the staff report contains detailed information concerning the operations of specialists on the NYSE, Amex and four regional exchanges. The data cover the specialist operation (as opposed to the overall firm effort) of every firm doing a specialist business on any one of the six exchanges. Pre-tax profit margins, the staff report says, are among the highest in the industry and very volatile. In 1978, these margins were

33.5%, 28.2% and 33.8% for specialists on the NYSE, Amex and regional exchanges, respectively. Specialists' revenues are derived from floor brokerage commissions and trading profits. Given below are the 1978 results for NYSE, Amex and regional exchange specialists:

Revenues and Profits of Specialists in 1978
($ Millions)

	NYSE	Amex	Regional
Floor Brokerage	$ 72.4	$13.8	$ 1.8
Trading Profits	65.3	11.2	14.2
Total Revenue	170.3	30.1	20.4
Net Income*	57.1	8.5	6.9
Return on Positions	22.7%	14.7%	18.4%

* Pre-tax.

The need to maintain trading inventories exposes specialists to a high degree of market risk, which they usually hedge with short positions amounting to roughly 20% of long positions.

Since the unfixing of floor brokerage rates in May 1975, the rates charged by NYSE specialists have declined approximately 24% from the old fixed level. In 1978, this represented roughly $2 million a month in revenues foregone and a cost reduction for upstairs brokerage firms.

Discount Brokers

For the first time, detailed information on discount brokers' operating results is provided in the report. There were at least 55 discounters at year-end 1978; the NYSE now has 17 members classified as discounters. These firms rely heavily on mass media advertising and execute unsolicited orders, and advertise retail commissions generally at half the old fixed rate schedule. Although discount brokers have only 0.3% of the equity capital and 0.6% of gross revenues of all NYSE firms doing a public business, they have obtained a 4.2% share of retail volume. Market share information for 1977-1978 is presented below:

Discount Brokers
Commission Revenue and Estimated Retail Market Share
(Dollars in Millions)

	1977				1978			
	I	II	III	IV	I	II	III	IV
Commission Revenue								
Industry Total	$838	$781	$785	$808	$742	$1,262	$1,292	$ 984
Retail Portion*	$572	$521	$530	$552	$512	$ 873	$ 916	$ 684
Discount Brokers' Commission Revenue*	$5.8	$5.8	$6.5	$8.4	$7.9	$ 14.7	$ 16.1	$14.6
Discount Brokers' Retail Volume Share*	2.0%	2.2%	2.5%	3.0%	3.1%	3.4%	3.5%	4.2%
Number of Discount Brokers	43	44	46	48	49	51	53	55

* SEC estimate.

Discounters are distinguished by an extremely high dependence on commission income -- 87.8% and 85.7% of gross revenues for 1977 and 1978, respectively. They are also distinguished by having achieved, for the same two years, profit margins and returns on equity far above the industry norm. Given below are these pretax returns, on a quarterly basis, for 1977-1978:

	1977				1978			
	I	II	III	IV	I	II	III	IV
Profit Margin	6.9%	7.9%	3.7%	3.1%	7.7%	23.3%	24.0%	3.5%
Return on Equity (Annualized)	38.4%	43.4%	21.4%	54.4%	47.2%	175.9%	150.4%	21.0%

The staff report emphasizes the degree to which the above returns exceed the industry norm but fails to note the volatility of the discounters' own returns, which certainly rivals the industry's profit volatility. The percentages of discount firms showing a quarterly loss are comparable to the industry-wide figures:

Percentage of Firms Showing a Quarterly Loss, 1977-1978

	1977				1978			
	I	II	III	IV	I	II	III	IV
Discounters	29%	31%	41%	36%	38%	17%	4%	49%
All NYSE Firms Doing a Public Business	30%	28%	33%	27%	41%	9%	6%	47%

A major difference between the earnings volatility of discounters and that of other firm categories is that the discounters' volatility seem to stem from operating -- as opposed to financial -- leverage. Despite the SEC's contention that competitive rates have caused marginal revenues to move closer to marginal costs, for discounters, at least, the two are far apart. Inspection of the expense data for discounters shows variable costs to be relatively low, the largest component being floor brokerage and clearance.

RR compensation is the industry's most important variable cost, having amounted to 18.3% of 1978 gross revenues.* For the discounters, in contrast, RR compensation was only 2.8% of 1978 gross revenues. This is in keeping with their policy of soliciting orders through mass media advertising rather than through the efforts of a retail sales force. Cost changes lag revenue changes for the discount brokers due to RR compensation practices. Also, because discount brokers largely avoid margin lending, a business in which interest revenues and interest expenses are closely linked together, the relationship between their marginal revenues and marginal costs is more remote than for firms active in margin lending.

The SEC's data on discount brokers are important to industry observers. The discounters' future market share experience will show what percentage of retail customers are trading-oriented investors willing to do without the traditional brokerage services in exchange for substantial discounts.

Conclusion

There is much more to praise than to criticize in the SEC staff report. We have singled out certain points above because these differences in interpretation and emphasis may be important in future deliberations at the SEC. However, we are in complete agreement with many other findings and statements contained in the report. For example, the conclusion that profitability does not increase with firm size is entirely consistent with our own analysis. Furthermore, both the SEC and SIA have demonstrated that profit margins and return on equity are more dependent on product and customer mix than on other variables.

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* Interest expense, though of comparable magnitude for the industry, differs from RR compensation in that it is not precisely a variable cost. Although interest expense varies with changes in margin lending activity and inventories held, it also responds to interest rate fluctuations and, to that extent, varies independently of changes in the level of business activity.

The SEC staff report is also to be commended for the depth and breadth of its data. Not only is there new data on discounters and specialists, but the information on other segments of the industry is very comprehensive. We believe that data on discounters and specialists are particularly important in tracking emerging trends in the industry. The 1978 report was the first SEC study to utilize the new SEC/SIA firm categories, and the income statement and balance sheet information for each category is of great value to industry observers. In these and other respects, a tremendous effort has been made by the SEC to meet earlier data requests by the SIA and others.

All in all, we applaud the Commission and staff for their effort and dedication. They have substantially improved both the format and the content of their report. We encourage the SEC to continue its efforts in this regard, and we recommend the staff report as required reading for all individuals interested in the securities industry.

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Director of Research

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SECURITIES INDUSTRY STATISTICS

VOLUME

	September 1979	YEAR-TO-DATE 1979	September 1978	YEAR-TO-DATE 1978	% CHG. Y-T-D 1979-1978
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	37.6	31.4	33.6	29.0	8.3%
AMEX (MILS.)*	5.4	4.1	5.7	3.9	5.1
NASDAQ (MILS.)*	15.4	13.8	14.0	11.2	23.2
REGIONAL EXCHANGE (MILS.)*	Not Available	---	3.4	3.1	---
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	21,647	172,717	19,716	153,150	12.5
AMEX (MILS.)	2,115	13,558	2,143	11,206	21.0
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	4,249	42,544	4,762	42,073	1.1
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	10,171	92,039	10,040	85,132	8.1
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	26.8	26.6	21.0	23.9	---
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	3,277	25,204	3,036	25,137	0.3
AMEX OPTIONS	1,646	12,158	1,307	10,963	10.9
COMMODITY	6,172	57,266	4,437	41,311	38.6
CBOE and AMEX OPTION VOLUME as a % of TOTAL NYSE VOLUME	69%	63%	69%	66%	---

* *MONTHLY AVERAGE*

YIELDS

(MONTHLY AVERAGES)

	OCTOBER 1979	OCTOBER 1978	BASIS POINT CHG. 1979-1978
BOND BUYER INDEX (20 BOND)	7.08	6.22	86
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	10.13	8.89	124
Baa CORPORATE	11.40	9.59	181
RATIO Aaa CORPS. TO Baa CORPS.	0.89	0.93	---
MUNICIPAL BOND YIELDS (MOODY'S)	6.25	5.53	72

PRICES

(END OF MONTH)

	OCTOBER 1979	OCTOBER 1978	PERCENTAGE CHANGE
DOW JONES INDUSTRIALS	815.70	792.45	2.9%
STANDARD & POOR'S 500	101.82	93.15	9.3
NYSE COMPOSITE	57.71	51.67	11.7
AMEX MARKET VALUE INDEX	203.64	136.75	48.9
VALUE LINE COMPOSITE	110.43	94.49	16.9
NASDAQ COMPOSITE	135.53	111.12	22.0

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	September 1979	Year-to-Date 1979	September 1978	Year-to-Date 1978
NET SALES*	-246.0	-1,816.1	-211.8	-1,376.9
NET PURCHASE OF COMMON STOCK*	-330.6	-2,601.3	-191.3	-1,152.8
NET PURCHASE OF OTHER SECURITIES*	- 78.9	689.9	4.6	- 449.6
MUTUAL FUND CASH POSITION	9.0%	---	7.8%	---

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	September 1979	September 1978	Percentage Change
MARGIN DEBT OUTSTANDING ($MILS)	12,000	12,400*	-3.2%
NET CHANGE IN MARGIN DEBT ($MILS)	-60	660	---
% OF ACCOUNTS WITH EQUITY UNDER 40%	10	12	---

* ALL TIME HIGH

UNDERWRITING
(DOLLARS IN MILLIONS)

	September 1979	Year-to-Date 1979	September 1978	Year-to-Date 1978	Absolute Chg. Year-to-Date	Percentage Chg Year-to-Date
CORPORATE FINANCING						
(Gross New Issues)						
Total	3,600	28,007	2,493	23,674	4,333	18.3%
Competitive	863	4,833	534	5,728	-895	-15.6
Negotiated	2,737	23,174	1,959	17,946	5,228	29.1
Common Stock	647	3,876	692	4,382	-506	11.5
# Of Common Stock Issues	34	223	37	198	25	12.6
Preferred Stock	191	1,390	98	1,490	-100	- 6.7
# Of Preferred Stock Issues	6	39	2	33	6	18.2
Corporate Debt	2,761	22,741	1,703	17,802	4,939	27.7
# Of Corporate Debt Issues	35	267	38	290	- 23	- 7.9
MUNICIPAL FINANCING*						
(Gross New Issues)						
Total	4,799	46,801	4,225	52,376	-5,575	-10.6%
Notes	2,534	16,974	1,936	17,313	-339	- 2.0
Bonds	2,265	29,827	2,289	35,063	-5,236	-14.9
# of Bond Issues	302	3,802	322	3,852	- 50	- 1.3
Negotiated Bonds	1,080	15,623	970	18,753	-3,130	-16.7
Revenue Bonds	1,490	20,267	1,530	21,357	-1,090	- 5.1

***Preliminary Figures**

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Second Quarter 1979	Second Quarter 1978	Percent Chg. 2nd Q. 1979 -2nd Q. 1978	First Quarter 1979	First Quarter 1978
REVENUE					
SECURITIES COMMISSION INCOME	998.9	1,118.1	-10.7%	857.5	639.6
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	675.5	436.5	54.8	624.3	329.3
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	189.2	201.6	- 6.2	173.6	145.2
TOTAL REVENUE	2,703.2	2,386.4	13.3	2,430.7	1,652.9
TOTAL EXPENSES	2,417.9	2,059.7	17.4	2,197.0	1,634.0
NET INCOME BEFORE TAXES	285.3	326.7	-12.7	233.7	18.8
PERCENT OF FIRMS SHOWING LOSS	13.7	9.0	---	18.6	40.6

SOURCE: FOCUS REPORT X-17A-20

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Are OPEC Financial Holdings a Danger to U.S. Banks or the Economy?	Report by the Comptroller General prepared in response to an inquiry by B. Rosenthal (Chrmn. House Subcom. on Commerce, Consumer & Monetary Affairs) concerning OPEC financial activities in the U.S.	U.S. General Accounting Office June 11, 1979
Rating Country Risk	A credit rating of 93 countries. Based on the judgment of 90 participating banks.	Institutional Investor September 1979 p. 243
List of OTC Margin Stocks	List of stocks traded over-the-counter that the Fed.'s Board of Governors has determined to be subject to margin requirements. Supersedes April 2, 1979 list.	Federal Reserve System October 1, 1979
Stocks: Plenty of Life Left	Article citing a number of market analysts who agree the market will rebound, though disagree on when.	Focus October 17, 1979 p. 134
Why Wall Street Looks Oversold	Discussion of current factors favorable to the economy, reasons mainstream investors have been unresponsive to them, and prediction of a market rally.	Economist October 20, 1979 p. 111
Funds Stayed Dry During Market Dive	Article reporting the pension funds managers' stablizing influence on the market during the October 8-12 plunge.	Pensions & Investments October 22, 1979 p. 1

ITEM	DESCRIPTION	SOURCE
A Funny Thing Happened on the Way to the Recession	Brief article on the United States' continued economic growth. Doubts of economists concerning the likelihood of Mr. Volcker's monetary measures stopping inflation are discussed.	Economist October 27, 1979 p. 33
Reduction of Tax on Capital Gains Spurs Investment	Evaluation of the 1978 capital gains tax roll-back finding evidence of a favorable impact, particularly on smaller companies.	Wall Street Journal October 31, 1979 p. 24
The Message from the Gold Markets	Comprehensive report on the ten-year-old U.S. effort to demonetize gold, and how and why it seems to be failing.	Fortune November 5, 1979 p. 54

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REMOVING TAX DISINCENTIVES DOES WORK

HIGHLIGHTS

1. There is strong evidence that the capital gains tax cut passed in late 1978 has been effective in stimulating certain sectors of the economy.

2. The performance of the stock market in 1979 has been in line with projections made last year about the impact of a capital gains tax cut despite generally more dismal economic and international developments than were foreseen.

3. In an Opinion Research Corporation survey of over 500 top and middle managers, one-quarter reported making new or increasing existing investments as a result of the reduction in the capital gains tax cut.

4. The sample respondents favored increasing investments in common stocks over other alternative investment vehicles.

5. Other indicators of the beneficial impact of the capital gains tax cut are: relatively higher price appreciation for the stocks of smaller capitalized companies; an increase in the amount of equity capital raised by smaller companies; and a marked pickup in venture capital investments.

6. Recently, the Senate Finance Committee approved a bill relieving the tax burden on interest and dividend income slightly. Such a bill is consistent with tax measures adopted recently by other nations to spur productivity, employment and competitiveness in world markets.

Introduction

The Revenue Act of 1978, passed last October, produced the first capital gains tax cut in over 40 years. Proponents had argued that the measure would encourage investment and capital formation. But, within the first few months of its passage, attempts were made to discredit the measure based on a lackluster stock market. More recently, former Secretary of the Treasury Blumenthal was quoted as saying that the capital gains tax cut did not lead to the benefits projected by supporters and a recent New York Times editorial supported this viewpoint. In all fairness, the Times article acknowledged that no specific tax policy can work in isolation.1/ Actually, there is strong evidence indicating that the capital gains tax cut has been highly effective in stimulating certain sectors of the economy.

This paper builds on a recent article in the Wall Street Journal which supported last year's reduction in the capital gains tax.2/ It incorporates new data demonstrating that lowering the capital gains tax did lead to specific benefits for the economy.

As the debate over our tax structure continues, questions about the efficiency of the capital gains tax cut are likely to reappear. This debate is likely to intensify during the upcoming Presidential primaries and campaign. Therefore, it is essential that the most comprehensive evidence about the effects of the capital gains tax cut be presented and analyzed.

Comments on the Views of the Critics

The concern about the relationship between the capital gains tax cut and monetary policy was noted by SIA in its comprehensive study of tax policy, investment and economic growth. Two sets of statistical tables were presented for each of the nine tax proposals analyzed in that study.3/ The first set assumed accommodating

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1/ See the New York Times, "Capital-Gains Tax Cut to Nowhere," December 4, 1979, p. A26. The Times noted that the tax cut on capital gains might have worked if there had not been deliberate government policies aimed at increasing the cost of money and slowing down economic growth.

2/ See Edward I. O'Brien, "Reduction of Tax on Capital Gains Spurs Investment," Wall Street Journal, October 31, 1979.

3/ See Securities Industry Association, Tax Policy, Investment and Economic Growth, Chapter 4 and Appendix A, March 1978.

monetary policy while the second set assumed non-accommodating monetary policy. Needless to say, the projected economic results from any of the tax cut proposals under non-accommodating monetary policy were quite modest and considerably less than that projected under the assumption of accommodating monetary policy. This fact is conveniently overlooked by most critics of the capital gains tax cut.

Another point glossed over by some critics concerns the argument that the stock market has not lived up to the expectations of proponents of the capital gains tax cut. Actually, there were wide discrepancies in the predictions by the three organizations which were most active in developing projections concerning the likely impact of a capital gains tax cut upon the S&P 500 Index's performance. The most optimistic forecast was that of Chase Econometrics Associates, which projected that the S&P Index would appreciate about 40% over its level without such a reduction by 1982.[4/] Merrill Lynch Economics, Inc. forecasted a much more modest increase -- 4% - 6%,[5/] while SIA predicted an increase of 10%. Readers may be surprised to learn that from November 30, 1978 to November 30, 1979, the S&P 500 Index increased 12.1% despite considerably higher inflation and interest rates and generally more dismal economic and international developments than those predicted by almost all forecasts last year. So the criticism that the stock market has not responded as anticipated by supporters of the capital gains tax cut has not been factual.

Investors Increased Their Investment Because of Lower Capital Gains Tax

Earlier this year, SIA commissioned Opinion Research Corporation (ORC) to undertake a survey of reactions by investors to different tax proposals. Although any tax proposal aimed at increasing savings and investment should appeal to all income groups, it is acknowledged that most such additional savings will come from those with higher earnings. Thus, SIA, in consultation with ORC, agreed to utilize ORC's quarterly Executive Caravan Survey, which is a sample of over 500 top and middle managers in the Fortune 800 companies. The October survey was used to evaluate responses to five alternative tax proposals, as well as other questions. One key question was: As a result of the changes in the capital gains tax law, did you make new investments, or increase existing investments during 1979?

[4/] Michael K. Evans, "The Economic Effects of Reducing Capital Gains Taxes," Chase Econometrics Associates, Inc., April 17, 1978, p. 7.

[5/] Merrill Lynch Economics, Inc., "Economic Impact Analysis of a Capital Gains Tax Reduction," August 22, 1978, p. 4.

The Executive Caravan sample represents a group of individuals particularly knowledgeable on tax regulations and investment alternatives. By understanding the attitudes and preferences of executives and managers, it should be possible to make judgments about the efficacy of alternative tax proposals as well as the capital gains tax cut last year. SIA plans on publishing and distributing the findings from the ORC survey early next year.

Preliminary Survey Results

The survey revealed that almost one-quarter of the sample reported making new or increasing existing investments as a result of the reduction in the capital gains tax. In addition, the respondents favored investment in common stocks over the other investment alternatives available for selection. The findings indicate that 15% of the respondents increased their purchases of common stock compared to 11% investing in real estate, the second highest category for new or increased investment.6/

The survey results also allow for an analysis of how different income groups responded to the capital gains tax cut. Table I classifies the data according to the respondents' incomes. A significant finding is that all of the income groups reported making new or increasing existing investments in response to the change in the capital gains tax law. The proportions ranged from 10% of those respondents with earnings under $30,000 to 36% of the individuals receiving more than $75,000.

The table also shows that investments in real estate were favored over common stocks by respondents with incomes lower than $30,000. But for each income category above $30,000, the proportion of the respondents making new or additional investments in common stocks was larger than for real estate as well as any other investment alternative. Evidently, given the proper incentive, common stocks are very desirable to those with funds to invest.

6/ The other categories of investment and the proportion of the Executive Caravan increasing investments in these categories were: mutual funds and preferred stock -- 3%, corporate bonds -- 1%, futures/options -- 1%, tangible investments -- 1%, tax shelters -- 1%.

Table I

THE RESPONSE TO THE REDUCTION IN CAPITAL GAINS TAXES BY INCOME GROUP

	Income				
	Under $30,000	$30,000-$39,999	$40,000-$49,999	$50,000-$74,999	$75,000 or Over
Percent of respondents who made new or increased existing investments as a result of the capital gains tax cut	10%	22%	18%	28%	36%
As a result of the changes in the capital gains tax, the percent of respondents who invested in:					
Common Stock	0%	12%	12%	17%	25%
Common Stock Mutual Funds and Preferred Stock	2	4	2	3	3
Corporate Bonds	0	1	0	0	2
Futures/Options	2	0	1	1	4
Real Estate	8	5	0	12	15
Tangible Investment	0	2	0	1	2
Tax Shelter	0	0	0	0	2
Unknown	0	0	1	0	1

Another variable used in the analysis was the relationship between additional investment and the value of the securities holdings of the respondents. The data disclosed that of the respondents with securities holdings of less than $25,000, 8% made new or increased existing investments in common stock; 16% of those with securities portfolios between $25,000 and $49,999 raised the level of their investments in common stock; and 25% of the executives with securities holdings of more than $100,000 put additional funds into the stock market. Clearly, the capital gains tax cut influenced many of the respondents to add to their securities holdings and the measure had a more substantial impact on those with larger portfolios. The magnitude of those increasing their stock and other investments is impressive in light of the economic, political and international uncertainties which were so evident.

Other Indicators

In addition to the responses of ORC's Executive Caravan, recent research by SIA has revealed that the main beneficiaries of lower capital gains taxes appear to be smaller companies as well as new venture capital enterprises. There are three principal early indicators of the effects of capital gains tax cuts: relatively sharper price appreciation for the stocks of smaller-capitalized companies; an increase in the amount of equity capital being raised by companies of all size as well as smaller corporations; and a marked pickup in venture capital investments.

Differences in Price Appreciation

The U.S. stock market offers a broad range of investment opportunities, each associated with a different level of risk and rate of return, ranging from heavily-capitalized issues represented by the Dow Jones Industrial Average and the S&P 500 Composite Index to smaller-capitalized issues represented by the American Stock Exchange Index (AMEX) and the NASDAQ Index. The smaller-capitalized issues are relatively more risky than the larger-capitalized stocks and presumably offer potentially higher returns. Institutional holdings, many of which are exempt from all taxes on income and capital, are predominantly in the larger-capitalized issues while individual investors have tended to invest in the smaller-capitalized stocks. Thus, any reduction in capital gains taxes which applies primarily to individuals should impact upon these two kinds of issues differently.

This is exactly what has happened, as can be seen by the strikingly different rates of appreciation of the indices representing larger and smaller-capitalized companies. From October 31, 1978 (when parts of the revised tax code were scheduled to become effective), to November 30, 1979, the Dow Jones Industrial Average rose only 3.8% and the S&P 500 14.0%; in contrast, the American Stock Exchange Index increased 66.6% and the NASDAQ Index rose 29.8%. Apparently, individual investors valued the stocks of smaller-capitalized and presumably higher profit-potential companies at substantially higher prices since the reduction in capital gains taxes.

Stock Offerings Are Up

Initial public offerings of common stock enable less known companies to raise equity capital. In attempting to measure the impact of tax policies on the level of new issues, there are other economic variables which must be taken into account. The overall stock market climate, which is influenced by many economic and political variables, is probably the most important influence on the level of initial public offerings. In spite of these factors, however, the impact of the tax policy change is clearly visible.

The volume of initial public offerings of common stock in 1978 was higher than any year since 1973 (see Table II). It is interesting that 75% of the value of 1978 initial public offerings was issued in the second half of that year, when Congress' approval of a reduction in the capital gains tax rate was already anticipated. Figures for the first half of 1979 show the value of initial public offerings to be about double the level of recent years.

discussed. Just recently, the Senate Finance Committee approved a bill which would increase the dividend exclusion from $100 for a single taxpayer and $200 for a joint return to $200 and $400, respectively. At the same time, interest receipts would also be eligible for this exclusion from income taxation.

Other nations have adopted tax measures aimed at promoting savings and capital formation to spur productivity, employment and competitiveness in world markets. The French Government, in particular, has developed a series of incentives along this line.8/

The emerging "gut" feeling of policymakers in this country and elsewhere that current tax policies impede savings and capital formation is also supported by the work of academicians. A path-breaking study published by Professor Michael Boskin concluded that policies which raise the after-tax return to capital will increase national income, eliminate an economic loss to society resulting from distortions of the consumption/saving choice and actually redistribute income from capital to labor.9/ Boskin found a positive relationship between savings and the real rate of return on capital. Thus, current tax policies on the returns from capital cause a decrease in savings and investment and a reallocation of consumption from the future to the present. A shift in tax policies away from taxes on capital or personal income to other tax bases will increase savings, capital investment relative to labor input, national income and eventually redistribute more of a larger pie to labor from capital.10/

Conclusion

The debate over Federal tax policy will likely command a great deal of attention from the Congress and Administration during 1980. The emerging evidence indicates that proponents of lower taxes on savings and investment should adopt an aggressive rather than defensive stance. The results of last year's

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8/ For a full discussion of the comprehensive program adopted by the French Government to encourage capital formation, see Rolf E. Wubbels, "The French Economic Miracle: What a Difference Leadership Makes," Financial Analysts Journal, July/August 1979, pp. 23-27.

9/ Michael J. Boskin, "Taxation, Saving, and the Rate of Interest," Journal of Political Economy, April 1978, p. S5.

10/ *Ibid.*, p. S23.

capital gains tax cut are impressive, particularly in light of a very unfavorable macroeconomic environment. Any comparison of tax policies between the U.S. and other major industrialized nations concerning capital gains, interest and dividend income would reveal the U.S. tax treatment as relatively severe. Additional initiatives are required to reverse this country's lagging capital investment and to encourage savings and capital formation.

Jeffrey M. Schaefer
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Director of Research

STATISTICAL HIGHLIGHTS

Good News at Last -- Almost

The industry in recent weeks has been the recipient of considerable doses of both good news and bad news. The good news involves the industry's earnings performance for the first three quarters of 1979. The bad news involves expected fourth quarter results, which will reflect the huge trading losses incurred in the aftermath of the Federal Reserve's October 6 credit tightening. The market turbulence created by the Fed's moves is known to have caused losses for numerous firms, but, for a variety of reasons, among them the unavailability of fourth quarter FOCUS data, it seems appropriate to discuss the good news first.

For the first nine months of 1979, the industry earned a 16.6% after-tax return on equity. This approaches the 17.6% earned in 1976, but the full year 1979 figure will undoubtedly be lower due to the October bath. Comparing the first nine months of 1979 with those of 1978, revenues increased 21.6%, while expenses increased 21.4%, indicating a slight improvement in profit margins. Despite an increase in NYSE average daily volume from 29.0 million to 31.4 million shares, commission revenues increased by only 1.3%.

Revenues of All NYSE Firms Doing a Public Business
First Nine Months
(Millions of Dollars)

Revenue Item	1978	%	1979	%	Percentage Increase 1979-1978
Commissions	$2,909.2	43.8%	$2,948.2	36.5%	1.3%
Trading & Investment	1,260.4	19.0	1,929.3	23.9	53.1
Margin Interest	795.7	12.0	1,140.9	14.1	43.4
Underwriting	584.5	8.8	574.5	7.1	-1.7
Commodities	244.2	3.7	321.8	4.0	31.8
Mutual Fund Sales	43.2	0.6	55.8	0.7	29.2
All Other	812.0	12.2	1,093.1	13.5	34.6
Gross Revenues	$6,649.2	100.0%	$8,087.7	100.0%	21.6%

Aside from the continuing decline of the commission business' relative importance, noted above, the most striking things about the revenue figures are the decline in underwriting income and the tremendous growth in trading and investment profits. The decline in underwriting is not surprising, given the capital market conditions prevalent through much of 1979. The growth in trading profits illustrates partly the rise of the dealer function and partly the rise of interest rates, since the FOCUS Report fails to isolate accrued interest and dividend income on inventory positions. The securities industry's increasing sensitivity to interest rate fluctuations is also displayed in the rise in margin revenues, since margin debt outstanding actually declined from $12.4 billion at September 30, 1978 to $12.0 billion a year later.

Expenses also demonstrate the industry's growing sensitivity to interest rate fluctuations, since interest expense was by far the fastest growing expense item. Securities firms borrow to finance both margin loans and inventory positions. At the end of the 1979 third quarter, the industry's receivables from customers and long positions amounted to $19.3 billion and $22.6 billion, respectively.

The collapse in securities prices that followed upon the Fed's actions ensures a disappointing fourth quarter, although the magnitude of those trading losses will not be known for several months. The industry's October experience -- which includes a record share volume day, record prime lending and T-bill rates, and the largest and probably most unsuccessful corporate underwriting in memory -- highlights dramatically the increasing risks borne by those in the securities business.

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Assistant Director of Research

SECURITIES INDUSTRY STATISTICS

VOLUME

	October 1979	YEAR-TO-DATE 1979	October 1978	YEAR-TO-DATE 1978	% CHG. Y-T-D 1979-1978
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	37.3	32.0	31.0	28.8	11.1%
AMEX (MILS.)*	5.4	4.3	4.5	4.0	7.5
NASDAQ (MILS.)*	15.2	13.9	7.3	10.8	28.7
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	25,434	198,151	19,180	172,330	15.0
AMEX (MILS.)	2,303	15,861	1,458	12,664	25.2
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	5,217	47,761	4,616	46,689	2.3
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	10,855	102,894	9,540	94,672	8.7
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	25.8	26.6	19.1	23.5	---
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	4,095	29,299	3,521	28,658	2.2
AMEX OPTIONS	2,115	14,273	1,457	12,420	14.9
COMMODITY	7,130	64,396	6,260	47,571	35.4
CBOE and AMEX OPTION VOLUME as a % of TOTAL NYSE VOLUME	72.4	64.2	73.0	66.3	---

* *MONTHLY AVERAGE*

YIELDS

(MONTHLY AVERAGES)

	November 1979	November 1978	Basis Point Chg. 1979-1978
BOND BUYER INDEX (20 BOND)	7.30	6.29	101
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	10.76	9.03	173
Baa CORPORATE	11.99	9.83	216
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.92	---
MUNICIPAL BOND YIELDS (MOODY'S)	6.49	5.59	90

PRICES

(END OF MONTH)

	November 1979	November 1978	Percentage Change
DOW JONES INDUSTRIALS	822.35	799.03	2.9%
STANDARD & POOR'S 500	106.16	94.70	12.1
NYSE COMPOSITE	60.71	52.89	14.8
AMEX MARKET VALUE INDEX	227.78	148.39	53.5
VALUE LINE COMPOSITE	117.56	97.60	20.5
NASDAQ COMPOSITE	144.26	114.69	25.8

UNDERWRITING
(DOLLARS IN MILLIONS)

	October 1979	Year-to-Date 1979	October 1978	Year-to-Date 1978	Absolute Change 1979-1978	% Change Yr-to-Date 1979-1978
CORPORATE FINANCING (Gross New Issues)						
Total	3,766	31,773	3,585	27,258	4,515	16.6%
Competitive	970	5,803	972	6,699	-896	13.4
Negotiated	2,796	25,969	2,613	20,559	5,410	26.3
Common Stock	802	4,678	1,006	5,388	-710	13.2
# Of Common Stock Issues	33	256	39	237	19	8.0
Preferred Stock	135	1,525	---	1,490	35	2.3
# Of Preferred Stock Issues	4	43	---	33	10	30.3
Corporate Debt	2,829	25,570	2,579	20,380	5,190	25.5
# Of Corporate Debt Issues	25	292	29	319	-27	8.5
MUNICIPAL FINANCING* (Gross New Issues)						
Total	4,521	51,648	4,545	56,923	-5,275	-9.3
Notes	476	17,471	1,273	18,588	-1,117	-6.0
Bonds	4,045	34,177	3,272	38,335	-4,158	-10.8
# of Bond Issues	324	4,283	390	4,250	33	-0.8
Negotiated Bonds	2,301	18,270	1,238	19,992	-1,722	-8.6
Revenue Bonds	2,981	23,461	1,994	23,351	110	0.5

*Preliminary Figures

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	October 1979	Year-to-Date 1979	October 1978	Year-to-Date 1978
NET SALES*	-214.1	-2,030.2	-179.8	-1,556.7
NET PURCHASE OF COMMON STOCK*	- 32.0	-2,633.3	- 30.1	-1,182.9
NET PURCHASE OF OTHER SECURITIES*	- 27.3	- 662.6	-205.9	- 655.5
MUTUAL FUND CASH POSITION	9.3%	---	8.8%	---

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	October 1979	October 1978	Percentage Change
MARGIN DEBT OUTSTANDING ($MILS)	11,310	12,090	-6.5%
NET CHANGE IN MARGIN DEBT ($MILS)	-690	-310	---
% OF ACCOUNTS WITH EQUITY UNDER 40%	13	21	---

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS (MILLIONS OF DOLLARS)

	Third Quarter 1979	Third Quarter 1978	Percent Chg. 3rd Q. 1979-3rd Q. 1978	Year-to-Date 1979	Year-to-Date 1978	Percent Chg. Y-T-D 1979-Y-T-D 1978
REVENUE						
SECURITIES COMMISSION INCOME	$1,099.1	$1,151.5	-4.6%	$2,948.2	$2,909.2	1.3%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	649.9	494.6	31.4	1,929.3	1,260.4	53.1
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	213.4	237.7	-10.2	574.4	584.5	-1.7
TOTAL REVENUE	2,966.9	2,609.9	13.7	8,087.7	6,649.2	21.6
TOTAL EXPENSES	2,626.6	2,259.5	16.2	7,226.4	5,953.2	21.4
NET INCOME BEFORE TAXES	340.4	350.4	-2.9	860.2	695.9	23.6
PERCENT OF FIRMS SHOWING LOSS	14.4	5.9	---	---	---	---

SOURCE: FOCUS REPORT X-17A-20

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Why the Experts are Nearly Always Wrong	A chapter excerpted from Contrarian Investment Strategy (D. Dreman). Author maintains stock market experts are predictably incorrect due to man's limitations as an information processor. Recommends random selection of stocks with low price/earnings ratios.	Forbes November 26, 1979 p. 117
A Grim Securities Industry Looks to a Restructuring	A one-page look at the problems facing the industry. Author urges Wall Street to work more closely with the banks and the federal government.	Business Week December 3, 1979 p. 103
Can We Stop Inflation?	Beginning with an overview of the rise of demand-side economics, this sixteen page report outlines the inflationary effects of the Keynesian premise that a built-in tendency to overproduce necessitates governmentally-stimulated consumption. Removal of production disincentives is suggested as a method of creating employment without inflation.	Paine Webber Annual Report 1979
Building a Better Future: Economic Choices for the 1980's	A study by NYSE economists, in cooperation with Wharton Econometric Forecasting Associates, of the U.S. economy's anti-investment bias and lagging productivity. Computer simulations show the likely impact on the nation's economy in the 1980's of various pro- and anti-investment tax policies.	New York Stock Exchange, Office of Economic Research

ITEM	DESCRIPTION	SOURCE
The Bomb IBM Dropped On Wall Street	Detailed account of the underwriting of IBM's ill-timed first debt issue. Discusses loss estimates and what the effect of a different pricing strategy might have been, as well as how this issue may affect future IBM offerings.	Fortune November 19, 1979 p. 52
Why Thrift has Become a Bad Joke in America	Brief article reporting the defection of Americans from savings institutions due to interest rates insufficient to counteract inflation. Relates efforts of banks, from legislation to promotional gimmicks, to fight the trend.	The Economist November 10-16, 1979 p. 101
British Stock Market: Freedom Hurts	A short piece detailing the abolition of exchange controls' negative effect on the British equity market. The future trend in interest rates is now the key to the market's level.	The Economist November 10-16, 1979 p. 101
A Long Road to New Underwriting Rules	Overview of the current debate on fixed-price underwriting.	Business Week December 3, 1979 p. 46
Verdict on the Volcker Measures	Interview with six banking executives on the expected impact of Paul Volcker's effort to tighten monetary credit.	Euromoney November 1979 p. 44
Japan's Securities Market 1980	A thirty-page report on principal trends of the securities market, concentrating on major developments in 1979. Numerous graphs support a text which includes summaries of structural changes in the economy, the health of the stock and bond markets, and the composition of shareholders.	Securities Public Information Center of Japan 1979

JUDITH S. WILLINGHAM

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

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PERSPECTIVE ON TRENDS IN THE SECURITIES INDUSTRY

(Address by Edward I. O'Brien Before the SIA Conference on Securities Industry Trends, January 23, 1980)

At the outset, I want to take this opportunity to welcome you to this important new undertaking, the first Conference on Securities Industry Trends.

As many of you realize, an event such as this does not just happen; it represents months of thought and dedicated effort of many in the industry and on the SIA staff. To each of them, to the speakers and panelists, I want to express my deepest appreciation.

I want to share with you a long-harbored dream. As a securities industry executive and as a lawyer I have felt that the financial and economic dimension of our industry is, coupled with sales and marketing, the industry's most important barometer and standard setter. For that reason, I have attempted to develop an economic and financial capacity at SIA to deal with the underlying capital, financial and economic ingredients of our business. Much has been accomplished to realize this goal over the last few years and this conference is in a way a reflection of the progress which has been made by the SIA in developing this capacity, as well as a foreshadowing of what we intend to do in the future. The SIA Firm and Industry Analysis Committee has been a major force in bringing this dream to reality and my special thanks to them, and to Jon Bulkley its present Chairman, and to Alan Blanchard an earlier Chairman.

One matter of special concern I want to mention today involves the SEC. The chant is often heard that our industry needs an advocate in Washington to propagandize on its behalf and the SEC is usually selected as the organization to act as the securities industry sponsor. It certainly is true that the securities industry's vital role and major contribution to the capital raising function has often been misunderstood and undervalued and this deficiency must be corrected. However, to ask the SEC to take on the role of industry advocate may be at the same time legally impossible and too much to ask. What is appropriate, however, is to expect the SEC to understand the underlying economic forces which shape our industry, which motivate our sales programs and which bear on the legislative and regulatory initiatives which impact our industry in particular and the overall capital requirements of our nation and its investors. This capacity has been sorely lacking at the Commission until a few years ago and in the last year special efforts have been undertaken by the Commission to meet what I perceive to be its obligation in this regard. The SIA has relished the opportunity to express to the Commission the need to build its economic capacity and we have been encouraged by the initiative of the Commission in this area. The establishment of the Directorate of Economic and Policy Research at the Commission and its support by the Chairman is a noteworthy event and we expect to see greater interest on the part of the Commission in at least three areas:

(a) Securities industry capital, its size, source, makeup and composition, as well as the need to change capital rules to keep up with the times.

(b) The economics of the industry, the makeup of its revenues, the expense picture, its profitability, all in so far as it relates to the public interest in being assured of a viable industry.

(c) The future direction of the industry, the new products and services to be developed, the relationship between the securities industry and others, such as banks, savings and loans, insurance companies.

All this economic interest has as its premise the need to know the economic facts in order to chart the direction of self-regulation, relations between complimentary or conflicting regulation and regulators, the so-called competition in regulation issue. Underlying this new economics intent of the SEC is the public requirement that competition is in the public interest and it should be fostered. At least this is the way the more enlightened elements of the industry see the emerging role of the SEC rather than saying that the Commission should be an industry partisan.

The securities industry changed more in the last ten years than many industries have changed in fifty. The days of gun-slinging portfolio managers and manual clearing seem as remote as the Model A Ford. Possibly more so. One good indicator of change is the level of output, a traditional yardstick of which is average daily volume on the NYSE. This went from average daily shares of 17.7 million in 1970 to 32 million shares in 1979. Two months ago, SEC Chairman Harold Williams spoke seriously of the imminence of 150 million share days.

A change even more striking than that in share volume is that share volume itself no longer reflects industry output as accurately as it once did. Securities firms, in their quest for greener pastures and less volatile earnings, have diversified into numerous activities, most of them within the financial area but some far outside of it. These are economic changes which will receive ample attention by other speakers today. I prefer to focus on the regulatory and political changes we have experienced in the past decade. There is a growing tendency to assume that all of the major regulatory changes originated in the 1975 Amendments, which is not the case.

The Stock Certificate

Before I consider further what has changed in ten years, I will discuss something which has not changed -- namely, the stock certificate. Ten years ago, many industry observers would have refused to believe that this item, which they considered a "barbarous relic," would be around in 1980. Barbarous relic or not, the stock certificate, like gold, is alive and well.

Ten years ago, this industry was knee deep in paper, and the stock certificate was a principal culprit. The unprecedented volume in the late 1960s short-circuited Wall Street's processing capacities, and faith in the securities markets and industry was fundamentally shaken. Underlying the difficulties were two main issues: broker/dealer financial responsibility and the need to streamline the clearing process. And at no other time in this industry's history were these two issues more nearly one.

Financial responsibility was, of course, the most urgent matter, and the actions taken were highly effective. More stringent net capital rules were established by the industry itself through the self-regulatory organizations. The NYSE disbursed millions of dollars out of its contingency fund and tapped its membership to safeguard customer accounts. Just as critical, was the passage in 1970 of the Securities Investor Protection Act, which gave investors the kind of protection bank depositors in this country had enjoyed for decades. In a word, the industry itself protected its clients.

On the subject of streamlining the clearing process, here too the progress has been substantial. The NYSE and securities industry took the initiative in establishing depositories, and the Depository Trust Company today holds roughly $300 billion worth of securities.

Firms began to automate in earnest. The resoundingly successful launching of NASDAQ in 1971 was just one step among many in bringing technology to the markets. An important goal for the future is to further reduce paperwork and develop the locked-in trade as part of the emerging National Market System.

Commission Rates

An even more significant development on the regulatory front was, of course, the abolition of fixed commission rates. The 1975 Amendments made competitive rates the law of the land, but the SEC had already, in a process stretching over seven years, made the unfixing of rates a *fait accompli*.

— In December 1968, a new fixed rate schedule providing for volume discounts went into effect. This was the first concession to the growing power of institutional investors. It would not be the last.

— In April 1970, a surcharge on brokerage commissions was approved and later incorporated into the commission rate schedule. It is important to keep in mind that throughout the early 1970s, as the steps toward unfixing proceeded, the fixed rate schedule was being increased. The last such increase was granted by the SEC in November 1974.

— In April 1971, commissions on that part of a transaction exceeding $500,000 were made negotiable. Again, this move was made in recognition of the ongoing institutionalization of the marketplace.

— In April 1972, this limit was lowered to $300,000.

— In September 1973, the SEC granted an increase in commission rates but announced at the same time that all rate fixing by exchanges would end on May 1, 1975.

— In April 1974, commissions became negotiable on all transactions involving less than $2,000.

— Mayday 1975, when it came, had long been anticipated and, many felt, largely discounted. Its impact was softened initially by a dramatic market recovery and by the fact that more than two years would elapse before institutional discounts reached their present levels.

— The process was not completed until May 1, 1976, when floor brokerage commissions were made subject to negotiation. It is clear from this chronology of events that the unfixing of rates started well before the

Securities Acts Amendments of 1975. The challenge for the 1980s in the pricing area is to link profitability in pricing for securities services with value in the investment services for clients.

ERISA

The passage in 1974 of the Employee Retirement Income Security Act, commonly known as ERISA, affected the industry in several key ways:

— Prior to ERISA, many corporations had discharged their pension obligations on a strictly pay-as-you-go basis. The ERISA-mandated funding of pension plans increased the pool of capital that is professionally managed and has been a major factor in the increasing institutionalization of the securities markets. In the five years from mid-1974 to mid-1979, the assets of private non-insured pension funds went from $129 billion to $212 billion, representing a 64% increase.

— ERISA has complicated the relationship between broker/dealers and pension fund accounts, swelling the costs of compliance. Its prohibited transactions provisions restrict securities firms to serving a pension fund account in only one capacity -- either as broker, market maker, investment advisor, underwriter, etc., and not as more than one of these.

— But it is the fiduciary liability provisions of ERISA that may well prove to have had the strongest impact upon both the securities industry and the overall economy. ERISA's prudent man rule has been given a very narrow interpretation, with predictable consequences for the capital allocation process. Risk aversion has been a salient feature of investment policy in the 1970s, and has contributed to the economic stagnation of the U.S. throughout the decade. The aversion to risk taking is a serious national preoccupation which must be overcome if our nation is to prosper and be able to compete internationally.

In 1978, only 58 corporations went public, as compared to 649 corporations in 1968. Conditions that have prevailed in the capital markets since 1972 have stifled smaller businesses and, through them, the entire economy. While these conditions are largely the result of inflation and its attendant phenomena, there is no denying that ERISA-type legislation has greatly raised the level of risk aversion among portfolio managers.

The 1975 Amendments

The 1975 Amendments grew out of the most extensive Congressional investigation of the securities markets since the Pecora hearings forty years earlier, and the changes they have wrought are comparable in scope.

The unfixing of commission rates was, as we have seen, already a fact by then. Other provisions of the '75 Amendments were to have consequences equally far-reaching if less immediate.

Section 11(a) of the Amendments mandated the separation once and for all of money management and brokerage. It was intended to eliminate the potential for account churning, and resolve the question of institutional membership on stock exchanges. The SEC has sought to reconcile the needs of different parties with the "effect versus execute" rule, whereby a broker/dealer can occupy the position of a commission-introducing broker with respect to agency business generated through institutional managed accounts.

The SEC was directed to remove impediments to a National Market System. A prerequisite for any National Market is equal regulation of all existing markets, something the Amendments achieved.

The interrelated goals of limit order protection and best execution are objectives of any National Market. While nothing like CLOB, the Central Limit Order Book, currently exists, the ITS now routinely channels orders in nearly 800 stocks to the market offering the best execution. And the Consolidated Tape has gone a long way toward uniting the different markets.

The future of regulations such as the NYSE's Rule 390, restricting member trading in listed securities to an exchange floor, remains unclear. But, as many observers predicted would happen, the importance of the third market greatly diminished since the unfixing of rates.

The most definite statement one can make concerning the National Market System is that no one knows for certain the form it will eventually take. Congress displayed great wisdom in granting the SEC broad discretionary powers concerning its implementation. And the SEC has likewise shown wise restraint in encouraging evolution with a demand for steady development. What needs to be emphasized is the industry's need for efficient markets with this efficiency finding its principal outlet in a sense of maximum interaction of orders to insure a fair price for buyers and sellers and reduced cost of execution of these orders.

The 1975 Amendments recognized that a national clearing system is comparable in importance to a national market system. This importance derives partly from a universal desire to avoid any recurrence of the paperwork problems of ten years ago and partly from the realization that technical compatibility of markets is as essential an ingredient of the National Market System as is equal regulation. In January 1977, the National Securities Clearing Corporation assumed the clearing operations of the NYSE, Amex and NASDAQ.

The relative ease with which our industry accommodated the record trading volume of the days following the Fed's credit tightening last October 6th shows how much progress has been made towards a national clearing system.

Removing Disincentives

I am optimistic by nature, as some of you may know, and it will not surprise you that I have saved the good news till the end. The good news for our industry -- and for industry in general -- comes from a most unexpected quarter: Washington, D. C. It involves more than just regulatory changes, however, being nothing less than an unmistakable change of heart towards business on the part of all branches of government. Faced with the erosion of our country's economic lead, government leaders, both elected and appointed, as well as the professional long-term government career person have been forced to re-appraise past policies. The most perceptive of them have realized that government, by enacting many anti-business measures over the past ten or fifteen years, has literally been biting the hand that feeds it. For, in taxation, as in many other things, less is more.

Ten years ago, government fiscal policy had not fundamentally changed since World War II. Fears of unemployment and recession remained uppermost in legislators' minds, and there was a consensus that the nation could stimulate itself out of any recession that came along. It was during this period that a conservative Republican president told a startled nation that, "We are all Keynesians now." As a matter of fact, many long-time Keynesians were beginning to have doubts.

The economic mainstream ten years ago downplayed the importance of the supply side of the economic equation, focusing instead upon manipulation of demand and income redistribution. If capital formation somehow got lost in the shuffle, this posed no real problem. Any economy possessed of sufficient demand could presumably take care of itself. In the exhilarating climate of the late 1960s, the U.S. economy seemed capable of doing just that -- low unemployment, low taxes and soaring transfer payments -- but the price tag for all this was the inflation that ultimately came to haunt us.

The Revenue Act of 1969 raised to 35% the maximum capital gains tax rate. Combined with a slowing economy and mounting price increases, the tax hike was a real blow to hopes for continued economic growth. And much worse was to follow: the Revenue Act of 1976 raised the maximum effective tax rate on capital gains to slightly over 49%.

Faced with a swiftly declining currency and a government set on penalizing investment, Americans did what anyone would do: they turned to consumption. There was a time when people would shrug off extravagant consumer outlays with the remark: "It's good for the economy." But the truth is -- it isn't good for the economy. Americans consume a scandalously high proportion of their incomes.

The record shows that income which could be used to improve our productive capacity is being dissipated in consumption. It could be argued that this produces no net loss of jobs, but the effects are only beginning to be felt. Our international competitive position has been weakened by the decline in investment and innovation. The U.S. is operating on an older industrial base than many other major industrialized economies, a situation that would have seemed incredible a generation ago. Industrial innovation -- by lowering costs per unit -- is a key weapon against inflation. The economy that fails to invest is committing itself to stagflation in the short run and obsolescence in the long run.

An elementary course in economics will define investment as foregone consumption. I can't resist the temptation to say that the opposite of delayed consumption is instant gratification, a poor lodestar, to be sure, in either business or government.

I ought not to speak too critically of those who choose to consume, however, when the government has provided so many disincentives to saving and investment. High capital gains and corporate income tax rates are prime examples.

I said I was saving the good news till the end, and I meant it. In November 1978, Congress provided the first reduction in capital gains tax rates in over forty years. At the same time, proposals to eliminate the double taxation of corporate dividends are receiving serious consideration from members of both political parties. This would have been unthinkable eight or ten years ago. We began the decade with a conservative Republican president telling us we've all gone Keynesian, and we ended it with a liberal Democrat denouncing big government and extolling business initiative. The fact that he was brought to this conclusion reluctantly does not change the basic fact.

Such measures are, granted, only a start. But they are laying the groundwork for a period of noninflationary economic growth. The securities industry has historically been a major beneficiary of noninflationary economic growth.

One final note is my conviction that we must turn our creative energies to a new direction in our country in the immediate future. We owe it to our fellow citizens to tell them that it is in their interest and that of our nation and future generations to reemphasize the goals of saving and investing rather than continuing our spending ways of the last 20 years. We need this new direction to strengthen and enrich our national spirit, to provide for our security today and for the heritage that we owe those who come after us.

Securities Industry Trends

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

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REFLECTING ON THE SECURITIES INDUSTRY DURING THE 1970s

HIGHLIGHTS

1. The securities industry mirrors general economic trends, exaggerating macroeconomic conditions on both the upside and downside. Just as the securities industry outperformed other industries in the 1960s, it underperformed other sectors in the 1970s.

2. Poor profitability and volatile market conditions are responsible for consolidation and growing concentration in the securities industry. The number of NYSE firms doing a public business declined from 444 at year-end 1973 to 374 as of September 1979. Over the same period, the largest twenty-five firms' share of gross revenues went from 47.8% to 69.8% and their share of industry capital from 47.4% to 67.7%.

3. Institutional discounting and depressed stock prices have caused a sharp decline in the relative importance of commission revenues, down from 55.4% of gross revenues in 1973 to 36.5% of gross in the first nine months of 1979. The increased interest in fixed-income securities have caused a big increase in the importance of the dealer function -- trading and investment activities accounted for 23.9% of gross revenues in the first nine months of 1979, up from 8.4% in 1973.

4. Despite the increased need for capital caused by the growing dealer business, the industry's total capital hovered around $4 billion for most of the 1970s. Nevertheles, it increased to $4.9 billion by the third quarter of 1979, a response to improved market volume and profitability.

5. Firms have successfully diversified away from the agency equity business, and larger firms are moving into areas outside the securities field. It is estimated that the largest publicly held firms in 1978 derived 8% of gross revenues from non-securities businesses. If traditional securities activities continue to produce an unacceptably low risk-adjusted return, this trend will persist.

Introduction

The securities markets mirror and accentuate overall economic trends, both on the upside and downside. The financial markets are at the focus of governmental policies aimed at slowing or accelerating economic growth. The 1960s, generally a boom period for the economy, was excellent for the securities markets and industry -- until many firms literally died of prosperity through the paperwork crisis.

The 1970s were disappointing economically for this country and even more so for the securities industry. The decade ended, as it began, with a recession on the horizon. Table 1 provides a few economic measures comparing the nation's economic performance in the 1960s with the 1970s. Both real GNP and productivity increased at much slower rates in the '70s compared to the '60s. On the other hand, the Consumer Price Index increased more in the 1970s.

Table 1

Compound Annual Rates of Increase

	1960-1969	1970-1979
% Increase Real GNP	4.5%	1.1%
" " Productivity	3.2%	1.7%
" " CPI	2.6%	7.3%

Profitability and Volatility

In terms of profitability, the securities industry generally outperformed the rest of the economy in the 1960s. (See Table 2.) This was particularly evident in 1967 and 1968, when the estimated after-tax return on equity in the securities industry was 22% or more. The euphoria changed abruptly in 1969 when profitability in the securities industry tumbled and never regained the lofty heights reached in 1967-68.

Table 2

After-Tax Return on Equity

	1966	1967	1968	1969	1970	1971	1972
Securities Industry	14.8	25.7	22.0	5.8	8.4	21.9	14.1
S&P 400 Industrials	12.9	11.8	12.3	11.9	10.2	10.8	11.7

	1973	1974	1975	1976	1977	1978
Securities Industry	(3.0)	0.7	16.6	17.6	6.9	10.9
S&P 400 Industrials	14.2	14.2	12.1	14.0	14.0	14.6

Just as the securities industry outperformed the rest of the economy in the 1960s, it has generally underperformed other industries in the 1970s. Except for 1971 and 1975 and 1976, profitability in the securities industry has been below the S&P 500 in the other five years. In addition, profit swings are much more volatile in the securities industry than for the S&P 500 industrial companies.

Consequences

Consolidation and Concentration

The relative lack of profitability in the securities industry combined with the extreme volatility of earnings led to several major developments in the 1970s. First, there was a sharp decline in the number of firms dealing with the public. (See Table 3.) This number plummeted from 444 in 1973 to 374 at the end of the third quarter of 1979. Even these numbers disguise the fact that many large and regional firms and research boutiques exited the industry while some smaller very specialized houses -- discount brokers, options firms, etc. have entered the industry recently.

Table 3

Number of NYSE Firms Doing a Public Business

1973	1974	1975	1976	1977	1978	9/30 1979
444	422	404	379	364	366	374

A sharp concentration of business in the securities industry accompanied the decline in the number of firms. (See Table 4.) From 1973 to 1979, the share of total capital of the largest 25 firms jumped from 47% to almost 68%. Similarly, gross revenues have gone from 48% to 70%, while commission revenues spurted from 42% to 62% over this same time period.

Table 4

Market Share of Largest Twenty-Five Firms

	1973	1979
Total Capital	47.4	67.7
Gross Revenues	47.8	69.8
Commission Income	42.3	61.8

Interestingly, despite this trend to larger and fewer firms, studies by both SIA and the SEC do not indicate that the largest firms achieved superior returns in the 1970s, and that size alone seems to be unimportant as a determinant of profitability. Rather, business and customer mix were far more important variables in determining the profitability of individual firms.

Diversification

A second major development resulting from the lack of profitability and the volatility of earnings has been the widespread diversification which took place in the industry. This resulted in a sharp decline in the relative importance of commission revenues. (See Table 5.)

Table 5

	1973	1974	1975	1976	1977	1978	9 mos. 1979
Commissions	55.4	49.1	49.9	45.8	41.8	42.7	36.5
Trading & Investment	8.4	12.8	15.6	20.3	19.3	17.5	23.9
Margin Interest	13.4	13.3	7.8	7.9	11.2	13.3	14.1
Underwriting	9.0	9.3	13.3	12.3	11.6	8.4	7.1
Other	13.8	15.5	13.4	13.7	16.1	18.1	18.4
Gross Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Commission revenues fell from 55% of total revenues in 1973 to about 36.5% through the first nine months of 1979. Even this decline is understated because until 1975 the listed options business was not even reported as a revenue source on FOCUS. Now, listed options account for over 10% of the commissions business.

The decline in the relative importance of commission revenues is well known to all of us. Basically, there are two reasons for this. The first results in great part from Mayday, which has resulted in institutional rates declining from 45-50% compared to the fixed rate schedule. The second is the fact that there has been little increase in stock prices. The lack of increase in stock prices and the increase in interest rates persuaded institutions to turn once again to bonds as investment vehicles. Institutions have taken assets out of equities and turned to fixed income securities. Table 6 shows the sharp decline in the percentage of assets of non-insured pension funds devoted to equities. In 1972, this percentage peaked at almost 75%, by 1978 the percentage was under 54%.

Table 6

Percentage of Assets of Private Non-Insured Pension Funds Invested in Equities

1970	1971	1972	1973	1974	1975	1976	1977	1978
64.1	69.8	74.6	68.4	56.6	60.8	63.1	56.1	53.5

The movement of institutions into fixed-income securities, mainly a dealer market, has caused firms to be more involved in trading and investment activities. The increase in the relative importance of trading and investment activities corresponds with the relative decline in the agency equity function. In 1973, trading and investment activities accounted for about 8% of gross revenues. (See Table 7.) Through the first nine months of 1979, such activities amounted to just under one-fourth of gross revenues of the industry. It is interesting to note that as part of the industry's diversification movement, which presumably is aimed at lowering the volatility of earnings, one of the fastest growth areas has been the sector where volatility is greatest, namely, trading activity.

Table 7

Relative Importance of Trading and Investment Activities

	1972	1973	1974	1975	1976	1977	1978	9 mos. 1979
Trading & Investment Profits as a Percentage of Gross Revenues	14.6	8.4	12.8	15.6	20.3	19.3	17.5	23.9

The growth of principal activities has made the securities industry both riskier and more capital intensive. A greater amount of capital is required to generate a dollar of revenues through trading activity as compared to the agency function. To make matters worse, the volatility of security prices has increased in the 1970s according to many observers.

Institutions were not the only ones who responded negatively to the lackluster stock market. Figures prepared by various sources indicate that individuals have been net sellers of equities since 1973. The NYSE Census reports of 1970 and 1975 reflect a sharp plunge in the number of stockholders. The 1980 Census is likely to show a similar result. It is evident that individuals are now seeking high-yield fixed-income securities. Simply review the phenomenal growth in money market funds as well as the change in the debt/equity ratio of mutual fund assets.

Industry Capital

The relative lack of profitability in the industry as well as its volatility has raised questions about the adequacy of industry capital. The amount of capital available to the industry was a major concern throughout the 1970s. Industry capital remained roughly around $4 billion. (See Table 8.)

Table 8

Securities Industry Capital
(millions of dollars, at year-end)

	1973	1974	1975	1976	1977	1978	9/30/ 1979
Total Capital	3,602	3,247	3,466	3,873	3,877	4,385	4,930
Equity Capital	2,526	2,343	2,690	3,103	3,113	3,424	3,924

Low profitability made it difficult to increase capital through retained earnings or to attract outside capital. The sources of outside capital have varied from individuals such as Ross Perot and oil shiekhs, to foreign banks and the Firestone Tire & Rubber Company. Some firms went public in 1971 and 1972, but market conditions since then have not favored such a trend.

Many individuals remain concerned about the adequacy of capital in the securities industry. They are particularly concerned when the major stockholders or partners of firms retire and wonder where new sources of capital will come from to replace retiring capital. However, as indicated in Table 8, the capital of the industry does respond when the profit outlook brightens. Note the sharp jump in both total and equity capital when profitability improves. Not only are retained earnings available, but market conditions allow firms to increase capital through private placements and subordinated borrowings.

Investment Banking

The lackluster stock market has led to a major change in business mix and the ability to raise capital by U.S. corporations. Underwriting public offerings, one of the major activities of the securities industry, has declined dramatically in relative importance due to lower P/E ratios and higher interest rates.

Since 1975, underwriting revenue as a percentage of gross revenues has declined continuously from 13% to just over 7% through the first nine months of 1979. (See Table 9.) The amount of capital raised via underwritings has bounced up and down during the 1970s -- peaking in 1975 after reaching a low in 1973. (See Table 10.) Furthermore, whereas the amount of equity capital raised by public underwritings varied from 20-25% from 1975 through 1978, this percentage will probably be under 20% in 1979. Except for 1976, the profitability of the investment banking business has been depressed because of the low level of public underwritings of equities.

Table 9

Underwriting as a Percentage of Gross Revenues

1973	1974	1975	1976	1977	1978	9 mos. 1979
9.0	9.3	13.3	12.3	11.6	8.4	7.1

Table 10

Capital Raised Via Underwriting

	1970	1971	1972	1973	1974	1975	1976	1977	1978	10 mos. 1979
Debt(%)	78	65	55	59	86	79	75	75	75	81
Equity(%)	22	35	45	41	14	23	25	25	25	19
Total ($Bils.)	$31.1	$39.1	$34.2	$22.7	$31.6	$46.8	$42.4	$36.7	$31.2	$31.8

One area of the investment banking business that has prospered has been private placements. The value of such activities jumped from $13.5 billion in 1975 to over $23 billion in 1978. (See Table 11.) Although the 1979 figures are likely to be less than 1978, they still will represent a dramatic increase over the activity in the early 1970s.

Table 11

Value of Private Placements
($ Billions)

1970	1971	1972	1973	1974	1975	1976	1977	1978	10 mos. 1979
6.4	9.1	11.8	12.2	10.7	13.5	21.2	25.7	23.5	14.9

The recent high level of merger and acquisition activity also results from depressed stock prices. This activity has been a source of countercyclical revenue for the industry and is as much a symbol of the 1970s market as the new issue business was of the 1960s market. Nevertheless, if stock prices rise, this need not mean that the M&A business will dry up entirely. Instead of cash exchanges for the stock of a company, stock swaps may become a means of mergers instead.

Municipal Offerings

Another area of investment banking that was strong in the 1970s was municipal securities. There was a sharp increase in the value of municipal securities offerings starting with 1975 when the figure jumped from $23 billion to just under $30 billion. (See Table 12.) Such offerings exploded in 1977 when they hit $45 billion. In 1978 and 1979 the total value of municipal securities has remained over $40 billion compared to well under $20 billion at the start of the decade.

Table 12

Revenue Bonds versus G.O.s

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
G.O.s(%)	66	67	62	56	57	51	50	40	39	30
Revenue Bonds(%)	34	33	38	44	43	49	50	60	61	70
Total Municipal Offerings ($Billions)	17.8	24.4	22.9	23.0	22.8	29.3	33.8	45.1	46.2	41.9

Not only has there been a sharp increase in the total value of municipal securities, but there has been a radical change in the distribution of these securities away from general obligation offerings to revenue bonds. This development parallels the widespread revolt against higher taxes and such developments as Proposition 13, which have limited the expansion of G.O.s and forced municipal and state governments to rely more and more on revenue bonds for new financing projects. Whereas G.O.s made up two-thirds of such offerings at the start of the last decade, they plummeted to 30% of all municipal security offerings last year.

The change in the composition of municipal securities has led to a public policy problem. Commercial banks are attempting to revise the prohibition on banks underwriting and distributing most revenue bonds. This has created a growing confrontation between the banks and the securities industry. Since the relative importance of revenue bonds will continue to increase, this battle between the banks and broker/dealers will continue, at least for the foreseeable future.

Changes in the Balance Sheet

Not only has the income statement of the securities industry changed radically in the 1970s, but the balance sheet underwent substantial change as well. First, there was a ballooning of the assets of the industry from under $19 billion in 1970 to over $74 billion as of the third quarter of 1979. (See Table 13.) The three assets which increased substantially were customer receivables, agreements to resell and long positions in securities, particularly in all government issues -- Federal, agency, state and local. The largest growth has been in reverse repos which have gone from just 7% of total assets in 1976 to 28% by the third quarter of 1979. (See Table 14.) Although customer receivables and long positions have also increased dramatically, they have declined in relative importance because of the sharp increase in reverse repos.

Table 13

Securities Industry Assets
(at year end)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	9/30/ 1979
Total Assets ($Billions)	18.6	22.8	27.1	20.7	19.8	22.7	38.2	43.6	53.9	74.1

Table 14

Composition of Assets

	First Quarter 1976	Third Quarter 1979
Receivables from Customers	36.0%	26.0%
Securities Purchased Under Agreements to Resell	6.8	28.0
Long Positions	34.8	30.5
All Other	22.3	15.5
Total Assets	100.0%	100.0%
($ Billions)	$24.6	$74.1

Margin lending is almost solely a retail activity with loans collateralized by stock purchases of the customer. The securities firm profits on the interest rate spread. Reverse repos have increased as a source of financing with broker/dealers trying to find both users and sources of funds. The focus here is not to try and take dealer positions but rather to earn a commission on bringing the two parties together or to earn interest on the difference paid by the user and received by the seller of funds. Thus, there has been a parallel growth in repurchase agreements on the liability side of the balance sheet.

Future Trends

The industry has successfully diversified away from the traditional "commission" business. In the 1970s, the industry helped to develop such products as mortgage-backed securities, money market funds, organized options trading and financial futures to meet the changing investment needs and desires of its customers. Some of these products or new lines of activity are displayed in Table 15.

Further diversification away from the traditional securities business seems likely in the 1980s. Moreover, some customers appear to desire dealing with a financial supermarket that caters to all their financial needs. Many of the major wirehouses are now stressing this approach, engaging in insurance, real estate brokerage, mortgage banking and leasing. The 1978 SEC Staff Report estimated that 8% of the revenues of the largest publicly held firms are now derived from non-securities business.

Table 15

The relative decline of agency equity business has caused firms to move into:

(1)
OTHER PRODUCT LINES

- Trading, mainly in debt
- U.S. Government Bonds
- Municipal Bonds
- Arbitrage
- Commercial Paper
- Commodities
- Financial Advisory
- Mergers & Acquisitions
- Private Placements
- Repurchase Agreements

(2)
NEW PRODUCTS

- Financial Futures
- Listed Options Trading
- Money Market Funds
- Tax Exempt Funds
- Mortgage Pass-through Securities

(3)
BUSINESSES OUTSIDE THE SECURITIES FIELD

- Insurance
- Leasing
- Mortgage Banking
- Timber, Oil Drilling and Exploration
- Real Estate

Capital will be diverted away from the securities business if the risk-adjusted return remains unacceptably low. Because of these diversification trends, a booming or lackluster stock market will have less impact on securities industry profits in the future than in the past. However, these profits will remain strongly correlated to stock price trends and transaction activity.

Dramatic changes will likely continue in the 1980s. If economic conditions improve and policymakers get a better handle on inflation and total government spending, the great potential pent-up demand for services offered by this industry may be unleashed. Hopefully, in terms of profitability, the securities industry will find the 1980s resembling the 1960s more than the 1970s.

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
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FURTHER EVIDENCE ON REMOVING TAX DISINCENTIVES

HIGHLIGHTS

1. Increased attention is being focused on "supply-side" economics, which stresses that the amount of labor and capital supplied in the market is strongly influenced by marginal tax rates. The findings of the recently completed SIA/ORC survey, Executives' Responses to Tax Proposals for Increasing Savings and Investment, lend firm support to this position.

2. The survey polls the reactions of over 500 executives to five tax proposals aimed at removing tax disincentives on savings and investment. A large favorable response in new or increased investment was drawn by each proposal.

3. Although common stock consistently placed first among the 11 asset choices based on the percentage of respondents increasing investment, dollars hypothetically committed to the various assets paints a somewhat different picture.

4. Mean dollar investment patterns confirm the tremendous popularity of property assets under the three tax proposals which do not discriminate among investment alternatives. As expected, no new money would flow to property assets under the two proposals to relieve the tax burden on dividends.

5. The lesson to be learned: If public policy is geared towards promoting equity investment, tax policies must be designed specifically attracting funds to such investments.

6. Although patterns of responses were similar in many respects, there were noticeable differences in the selection of investment alternatives among age categories and income groups.

Introduction

Lately, more and more commentators have criticized past tax policies originating in Washington, noting the emphasis on redistributing income first from the affluent, and later from the middle class, to other groups deemed deserving by the government. This policy promotes consumption at the expense of savings and investment. In addition, present tax policy serves to exacerbate this situation by ignoring the impact of inflation on assets and investments. Given the nation's present double-digit inflationary environment, savings and investment flows have been distorted. To maintain their standard of living, most income groups have upped spending and decreased savings and investment.

Today, there is a growing realization that tax policy can affect not only changes in demand but changes in supply as well. Reducing tax disincentives on savings and investment should increase the supply of capital because of shifts from consumption to savings and from tax shelters to more productive uses of capital. Estimates of the underground economy alone now range from $100 billion (an IRS estimate) to just under $180 billion.1/ The earlier focus on aggregate demand is being challenged by "supply-side" economics which stresses that the amount of labor and capital supplied in the market is influenced strongly by marginal tax rates.2/

Many leaders from Washington and academia are calling increased attention to the important link between taxes and the supply of labor and capital for productive uses. For example, Martin Feldstein has pointed out that eliminating the capital gains tax on publicly traded securities would provide an incentive to invest in corporate equities instead of gold, land, housing and other assets that do not contribute to productivity.3/ Congressman Jack Kemp noted that in November 1979 the savings rate fell to its lowest level -- 3.3% -- since the government began keeping monthly figures in 1959.4/

1/ Peter Gutmann, "The Subterranean Economy," Financial Analysts Journal, November-December 1977.

2/ Paul Craig Roberts, "The Breakdown of the Keynesian Model," The Public Interest, Summer 1978.

3/ See his address "Inflation and the Taxation of Capital Gains: A Proposal," before the Tax Conference of the Continental Bank on December 4, 1979.

4/ See Testimony of Congressman Jack Kemp before the House Ways and Means Committee, January 31, 1980.

In addition, the Report of the Joint Economic Committee recommended that one-half of the next tax cut be directed to enhancing savings and investment.

Results Reported Earlier

Like many others, we strongly believe that restructuring the tax system would produce important changes in the economy. Several months ago, we explained how the cut in capital gains taxes enacted in the Revenue Act of 1978 had been highly effective in stimulating certain sectors of the economy.5/ In these earlier papers, we noted the relatively sharper price appreciation for the stocks of smaller capitalized companies; an increase in the amount of equity capital being raised by companies of all sizes; and a pickup in venture capital investments. Also presented were preliminary data from an SIA commissioned survey carried out by Opinion Research Corporation (ORC). This data contained the responses of more affluent investors to changes in capital gains taxes passed in 1978. Among the study highlights was the finding that almost one-quarter of the sample reported making new or increasing existing investments because of the reduction in capital gains tax. Moreover, almost 10% of the sample reported realizing gains as a direct consequence of the Revenue Act.

In this paper, we will present results from the completed SIA/ORC survey, concentrating on prospective responses.6/ We will also analyze some of the data not contained in the survey but available from the computer print-outs of responses to the various tax proposals.

The Survey

A series of possible tax proposals to increase savings and investment by individuals have been discussed by SIA. Among these proposals, the following five were tested:

5/ Edward I. O'Brien, "Reduction of Tax on Capital Gains Spurs Investment," Wall Street Journal, October 31, 1979; and Jeffrey M. Schaefer, "Removing Tax Disincentives Does Work," Securities Industry Trends, December 17, 1979.

6/ Copies of the 24 page survey Executives' Responses to Tax Proposals for Increasing Savings and Investment, including graphics, are available from SIA's Research Department. The cost is $3.00 per copy for members and $5.00 per copy for non-members.

1) A maximum tax of 50% on investment income;

2) Roll-over of invested capital through deferral of capital gains tax;

3) Reduction of the capital gains holding period to six months;

4) Reduction or elimination of double taxation of dividends; and

5) An increase in the dividend exclusion to $500 for individuals and $1,000 for joint returns.

Four of these proposals or versions resembling them have been introduced in the last two years in Congress, while a fifth, reducing the length of the holding period, has been advocated by some securities industry representatives. SIA hoped to learn how persons who could benefit from the enactment of such proposals would assess them in order to determine which had the greatest potential for stimulating savings and investment. For this reason, SIA requested ORC to include a series of questions in its quarterly Executive Caravan Survey.7/ Respondents were not told that the tax proposals were being studied by SIA.

Survey Results

Reactions to the five tax proposals varied considerably in terms of the percentage who stated they would make new or increased investments in various investment alternatives. They also varied in percentages who would increase their holdings of common stock. Furthermore, there were significant differences in the mean amount of new funds channeled to equities. These findings are highlighted in Table 1.

7/ The Executive Caravan Survey is sponsored by multiple clients of ORC and is conducted via personal interviews among a sample of top and middle managers in the "Fortune 800" companies. For this survey, interviews were conducted with 516 individuals from October 15-November 15, 1979.

Table 1

RESPONSES TO ALTERNATIVE TAX PROPOSALS

	1. Maximum Tax of 50%	2. Deferral of Capital Gains Tax	3. Reduction of Capital Gains Holding Period	4. Reduction of Double Taxation of Dividends	5. Increase in Dividend Exclusion
Would make investments	55%	69%	48%	74%	60%
Would invest in common stock	31%	42%	39%	67%	54%
Mean stock investment (all executives)	$ 8,100	$10,500	$ 9,800	$12,800	$ 5,800
Mean stock investment (those who would invest only)	$26,100	$25,100	$25,000	$19,100	$10,800

According to the data, removal of tax disincentives to investment would stimulate a large favorable response based on the percentage increasing or making new investments.8/ The proposal to reduce or eliminate the double taxation of dividends registered the highest percentage -- 74% -- while reducing the holding period back to six months was the only proposal drawing a response under 50%.

With respect to common stocks only, the proposals aimed specifically at securities, 4 and 5, attracted the highest proportion of respondents to common stock -- 67% and 54%, respectively. In terms of the dollars committed to equities, the reduction or elimination of double taxation of dividends again placed first. Interestingly, an increase in the dividend exclusion had the lowest mean as respondents correctly perceived the "ceiling" on the amount of tax that would be saved.

If only investors responding positively to the tax proposals were included in the analysis, the reduction or elimination of double taxation of dividends fell from first to fourth concerning the mean amount of money flowing to equities. Apparently, investors

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8/ Although respondents may always be inclined to answer more optimistically than their actual behavior later on, these percentages are still so impressive that the likelihood of favorable investment action remains high.

who responded positively to the lowering of tax disincentives would do so in considerable amounts if the maximum tax were lowered from 70% to 50%, if capital gains taxes were deferred, or if the required holding period were reduced.

Mean Dollar Investment Patterns

Although common stock consistently placed first in terms of the percentage of respondents increasing investment under each tax proposal, an analysis of dollars hypothetically committed to various investment vehicles paints a somewhat different picture. Before assessing the mean dollar pattern of asset selection, it would be germane to review the performance during the past ten years of some of the assets considered. To say the least, the 1970s were not kind to the capital markets. With the acceptance of inflation as the nation's number one problem, the stock and bond markets lost their long-held position as the nation's most popular investment vehicles. In a scramble to beat the rising rate of inflation, many investors turned to less traditional, and in some cases more speculative, forms of investment. The real estate and housing markets boomed, and the popularity of these assets is confirmed by the high mean dollar investment executives in the survey were willing to commit to such assets.

Property values have escalated dramatically, with the median house price climbing from $20,100 to $56,500 between 1968 and year-end 1979. The amount of mortgages outstanding for one-to-four family homes leaped from $345 billion to $875 billion between year-end 1972 and year-end 1979. In addition, tax advantages are built into owning real estate or a home, whereas little or none exist for other assets. For example, both property taxes and the interest costs of carrying a mortgage are deductible for income tax purposes. In contrast, with inflation pushing individuals into higher and higher income brackets, the taxation of interest receipts and double taxation of dividends have become even greater disincentives to saving and investing.9/

During the 1970s and particularly in recent years, the value of art, gems, gold and other tangibles has grown immensely. Art prices have appreciated roughly 10-16 times over the decade, and precious gems, metals, and especially gold have experienced an astronomical climb. In 1971 gold was demonetized, and its price remained below $40 until 1972. While the price of gold has since risen and fallen with swings in inflation, political uncertainty,

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9/ Attached to the Windfall Profits Tax bill, which was passed by the House on March 13, is a provision that $200 of interest or dividends be made tax exempt for single individuals and $400 for joint returns. This replaces the $100/$200 exclusion for dividend income only.

and the strength of the dollar, it topped $800 in January of this year.

Finally, it should be noted that the survey was conducted in October-November 1979. At the start of the new year, gold reached its pinnacle but has been headed downward ever since. On the other hand, record trading volume and stock price appreciation were registered on all stock markets and, although volume and prices have fallen recently, there is still much discussion of many undervalued stock market opportunities, particularly in companies endowed with natural resources.

Table 2 shows that regarding the mean amount of money committed to new or existing investments, the roll-over allowing for deferral of capital gains tax and lowering the maximum tax to 50% for all income sources generated the highest means -- $75,600 and $49,000, respectively. The smallest means were reflected in the two proposals which would benefit investment in securities only -- the reduction or elimination of double taxation of dividends and an increase in the dividend exclusion. The reduction or elimination of double taxation on dividends not only generated the highest mean investment in equities -- $12,800 -- but in all corporate securities (equities, mutual funds, preferred stocks and corporate bonds) -- $19,300 -- as compared to the maximum tax of 50% which was second highest in generating a mean of $15,500 in new investment in corporate securities.

The tremendous popularity of real estate investment is dramatically demonstrated under the roll-over and maximum tax of 50% proposals. Of the $75,600 in mean new investment resulting from the roll-over proposal, $58,000 or over 75% would be invested in housing or real estate. For the maximum tax of 50%, almost 60% of the $49,000 in new mean investment would be channeled to housing or real estate. As expected, no new money would flow to the housing or real estate market under the two proposals relieving the tax burden on dividends.

There is an interesting lesson to be learned from Table 2. If public policy is geared toward promoting equity investment, tax policies must be designed specifically attracting funds to such investments. If, on the other hand, public policy is aimed rather at increasing aggregate investment without regard to the distribution of funds, tax policies can and should be constructed differently. Given the recent price trends in the housing and real estate market, a large proportion of additional investment would flow to these sectors under tax proposals which do not discriminate among investment alternatives. Right now, this may not be a desirable public policy objective.

Table 2

MEAN INVESTMENTS UNDER EACH PROPOSAL BY ASSET

	Maximum Tax of 50%	Deferral of Capital Gains Tax	Reduction of Capital Gains Holding Period	Reduction of Double Taxation of Dividends	Increase in Dividend Exclusion
Common stocks	$ 8,100	$10,500	$ 9,800	$12,800	$ 5,800
Common stock mutual funds	700	1,200	800	2,500	1,500
Preferred stocks	1,700	1,700	900	2,900	1,500
Corporate bonds	5,000	900	400	1,100	900
Real estate other than home	13,000	25,500	6,100	--	--
House or condominium	7,000	21,000	6,100	--	--
Rental property	9,100	11,500	1,300	--	--
Tax shelters	1,800	1,700	300	--	--
Futures	1,100	100	200	--	--
Options	400	1,000	600	--	--
Tangible investments	1,100	500	1,000	--	--
TOTAL	$49,000	$75,600	$27,500	$19,300	$ 9,700

Note: Figures are hypothetical mean investments across the total executive sample.

Common Stock Investment by Age Group

This section examines the data from the SIA/ORC survey and focuses on mean dollar investment by age and income categories in 6 of the 11 asset choices: common stock, corporate bonds, real estate other than home, house or condominium, tax shelters, and tangibles.

Proposal 4 was found the most encouraging for common stock investment across all age and income categories. Other means of enhancing the attractiveness of common stock to younger investors, the under 40 age group, were proposal 2 which produced the second highest mean, $4,600, and proposal 5 which produced the third highest, $3,700. In the 40-49 age bracket, proposals 2 and 3 stimulated almost equal mean investments in common stock, about $9,000, making these two proposals the next most desirable for that particular age group. For the over 50 group, proposal 2 would promote as much as 88% of the mean investment committed under proposal 4. Proposal 5 was the least effective for the older age group because many were in the highest income categories and the "ceiling" on the amount of tax saved was insufficient to step up investment.

Asset Investment by Age Group

Proposal 1 - Maximum Tax of 50%. The largest mean investment by all three age groups was in real estate other than home, ranging from $9,900 to $16,100. While house or condominium was the second priority for the two younger groups, the 50 and over group turned to common stock and corporate bonds. The under 40 age group evidenced a surprisingly strong interest in tangibles under this proposal, about 4.6 times stronger than the 40-49 group and 2 times more than the 50 and over group. As tangibles have come into vogue in the past decade, the younger group would be more attuned to profit potential in these assets and not as averse to the risk involved as the older age categories. Data in the income analysis section of this report support this tendency of younger investors. The youngest group also showed a preference for tax shelters that was equal to that of the oldest group and twice that of the middle group.

Maximum Tax of 50%
Mean Investment by Type of Asset and Age Group

Age	Common Stock	Corporate Bonds	Real Estate Other Than Home	House or Condominium	Tax Shelter	Tangibles
Under 40	$ 1,300	$ 3,700	$ 9,900	$4,900	$1,900	$3,900
40 - 49	6,900	4,200	16,100	7,000	930	850
50 & Over	12,500	11,200	15,700	7,000	1,900	2,000

Proposal 2 - Deferral of Capital Gains Tax. Mean dollar investment responses to proposal 2 followed almost the same pattern as proposal 1. The two property investment vehicles were the first and second choice of all three age groups for increased investment, with the dollar mean falling between $13,400 and $26,100 for the two assets. Under this proposal, the third choice for all groups was common stock. Common stock investment as a percentage of the investment in real estate was: 23% for the under 40 group, 41% for the 40-49 age group, and 58% for the 50 and over group. The interest of the under 40 group in tax shelters surpassed that of the middle age group and was 75% of the oldest group.

Deferral of Capital Gains Tax
Mean Investment by Type of Asset and Age Group

Age	Common Stock	Corporate Bonds	Real Estate Other Than Home	House or Condominium	Tax Shelter	Tangibles
Under 40	$ 4,600	$ 330	$20,000	$13,400	$2,100	$ 450
40 - 49	9,100	1,000	22,200	16,900	1,400	1,200
50 & Over	15,100	1,600	26,100	21,600	2,800	900

Proposal 3 - Reduction of Capital Gains Holding Period. Under proposal 3, the two older age groups reported they would make particularly large investments in common stock in comparison to the alternative choices. Common stock investment by the 40-49 group was 3.2 times the investment in the group's second choice, house or condominium. For the 50 and over group, common stock investment was 1.8 times larger than the second choice, real estate. Corporate bonds, the older group's third choice, registered almost 90% as much as the investment in real estate.

Reduction of Capital Gains Holding Period
Mean Investment by Type of Asset and Age Group

Age	Common Stock	Corporate Bonds	Real Estate Other Than Home	House or Condominium	Tax Shelter	Tangibles
Under 40	$ 2,700	$ 50	$12,300	$7,700	$400	$800
40 - 49	9,300	1,400	2,500	2,900	280	850
50 & Over	11,200	5,600	6,300	2,100	370	600

Proposal 4 and 5 - Reduction of Double Taxation of Dividends and Increase in Dividend Exclusion. These two proposals alleviate the tax burden associated with securities investment only. Consequently, common stock was the first choice by all three age groups.

Asset Investment by Income Group

A detailed analysis by income level of the mean investment in common stocks is included in the study. The following analysis compares the mean common stock investment with five other assets. In some of the data highlighted, the correlation between age and income level also affects investment patterns.

Proposal 1 - Maximum Tax of 50%. Responses of executives in the under $30,000 income bracket were heavily weighted toward corporate bonds and tangibles. Common stock was the third choice, but the increased investment recorded was only 24% of the investment in corporate bonds. Housing and real estate were minor factors for this income bracket. Individuals in the lowest income class were unlikely to face marginal rates over 50% during the reporting year. Thus, this proposal was unlikely to stimulate additional investment by them unless they were considering future trends in their income. In the two income classes encompassing $30,000 to $49,000, the property vehicles took the lead, with the lower of the two income groups selecting tangibles third and the higher, electing common stocks. Real estate other than home was the first choice of the $50,000 to $74,000 income group, followed by investment in corporate bonds and common stocks.

Maximum Tax of 50%
Mean Investment by Type of Asset and Income Level

Income Level	Common Stock	Corporate Bonds	Real Estate Other Than Home	House or Condominium	Tax Shelter	Tangibles
Under $30,000	$ 2,000	$8,200	$ 1,700	$ 1,700	$ 100	$6,500
$30,000-$39,000	850	180	10,500	3,900	750	1,300
$40,000-$49,000	2,700	1,700	16,400	13,500	1,100	680
$50,000-$74,000	4,500	4,900	17,500	4,000	1,900	1,600
$75,000 & Over	23,000	6,800	12,000	8,600	3,500	2,400

Proposal 2 - Deferral of Capital Gains Tax. All income groups opted for the property assets as their first and second investment choices. With the exception of corporate bonds as the third selection of the under $30,000 income group, common stock received the third highest investment mean by all income groups, averaging between 31% to 59% of the investment in property.

Deferral of Capital Gains Tax
Mean Investment by Type of Asset and Income Level

Income Level	Common Stock	Corporate Bonds	Real Estate Other Than Home	House or Condominium	Tax Shelter	Tangibles
Under $30,000	$ 1,500	$2,800	$19,600	$13,100	$1,900	$ 100
$30,000-$39,000	3,200	350	9,200	6,500	630	230
$40,000-$49,000	7,100	1,300	19,500	22,600	180	880
$50,000-$74,000	10,300	1,100	25,100	10,400	680	1,900
$75,000 & Over	25,200	800	39,800	33,700	7,300	1,200

Proposal 3 - Reduction of Capital Gains Holding Period. Behavioral patterns were slightly reversed under this proposal. While property assets remained the predominant interest of the two lower income brackets and common stock placed third, the $40,000 and up income groups chose common stock first. Mean investment of the upper income groups in common stock as compared with mean real estate investment ranged from 1.2 to 1.7 times more.

Reduction of Capital Gains Holding Period
Mean Investment by Type of Asset and Income Level

Income Level	Common Stock	Corporate Bonds	Real Estate Other Than Home	House or Condominium	Tax Shelter	Tangibles
Under $30,000	$ 1,300	$ 800	$2,300	$6,900	$100	$ 100
$30,000-$39,000	4,400	0	4,800	5,400	150	100
$40,000-$49,000	3,900	530	2,600	1,600	350	280
$50,000-$74,000	6,900	600	5,600	4,600	200	1,400
$75,000 & Over	16,700	1,100	9,600	3,900	880	1,600

Proposal 4 and 5 - Reduction of Double Taxation of Dividends and Increase in Dividend Exclusion. As borne out by the age analysis, these two proposals promoted selection of common stock for the highest increased or new investment. Under proposal 4, the mean investment was $4,700 for the lowest income group and $30,900 for the over $75,000 group. Under proposal 5, mean investment ranged between $3,400 and $10,600.

Summary

With both inflation and taxes taking ever-growing chunks out of the real rates of return to savers and investors, the data available from the SIA/ORC survey confirm that property assets, and to a lesser degree tangibles, have gained recognition as hedges against inflation. Thus, investable funds are being diverted from financial to real assets. The consequences for borrowers in the capital markets are ominous and particularly so for small business. Government and large corporations are the major contenders for the shrinking pot of investable funds, but small business has perhaps the greater need and the smaller chance of obtaining financing.

Plainly, the effectiveness of proposal 4 in stimulating increased securities investment cannot be disputed. While proposal 5 generated the lowest dollar mean because of the ceiling placed on the dividend exclusion, executives across-the-board selected common stocks as the favored investment vehicle. If the lid on the exclusion were removed, the proposal would eliminate the double taxation of dividends. An adjustment such as this would change the lukewarm reception given proposal 5 to an extremely positive one. To ensure the revival of securities investment and foster economic growth, tax policy must be renovated with that particular intent. The SIA/ORC survey supports a forceful case for the removal of tax disincentives -- the worsening economic environment over the past years presents an unquestionable one.

Jeffrey M. Schaefer
Vice President and
Director of Research

Carolyn Hildebrandt
Associate Director
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SECURITIES INDUSTRY STATISTICS

VOLUME

	January 1980	YEAR-TO-DATE	January 1979	YEAR-TO-DATE	% CHG. Y-T-D 1980 - 1979
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	52.7	52.7	28.0	28.0	88.2
AMEX (MILS.)*	9.4	9.4	3.2	3.2	193.7
NASDAQ (MILS.)*	29.2	29.2	11.1	11.1	163.0
REGIONAL EXCHANGE (MILS.)*	6.0	6.0	3.1	3.1	93.5
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	37,424	37,424	18,337	18,337	104.1
AMEX (MILS.)	3,414	3,414	1,053	1,053	224.2
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	7,306	7,306	4,905	4,905	49.0
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	13,473	13,473	9,187	9,187	46.7
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	31.3	31.3	25.1	25.1	—
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	4,999	4,999	3,337	3,337	49.8
AMEX OPTIONS	2,795	2,795	1,539	1,539	81.6
COMMODITY	6,994	6,994	5,601	5,601	24.8

* *MONTHLY AVERAGE*

YIELDS

(MONTHLY AVERAGES)

	February 1980	February 1979	Basis Point Chg.
BOND BUYER INDEX (20 BOND)	8.16	6.31	185
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.38	9.26	312
Baa CORPORATE	13.57	10.08	349
RATIO Aaa CORPS. TO Baa CORPS.	0.91	0.92	—
MUNICIPAL BOND YIELDS (MOODY'S)	7.28	5.66	162

PRICES

(END OF MONTH)

	February 1980	February 1979	Percentage Change
DOW JONES INDUSTRIALS	863.14	808.82	6.7%
STANDARD & POOR'S 500	113.66	96.28	18.1
NYSE COMPOSITE	64.95	53.93	20.4
AMEX MARKET VALUE INDEX	303.48	160.74	88.8
VALUE LINE COMPOSITE	124.50	101.63	22.5
NASDAQ COMPOSITE	158.03	122.56	28.9

UNDERWRITING
(DOLLARS IN MILLIONS)

	February 1980	Year-to-Date 1980	February 1979	Year-to-Date 1979	Absolute Change 1979-1980	% Change Yr-to-Date 1979-1980
CORPORATE FINANCING (Gross New Issues)						
Total	2,731	6,489	2,692	5,143	1,346	26.2%
Competitive	363	932	709	1,247	(315)	(25.3)
Negotiated	2,368	5,557	1,983	3,896	1,661	42.6
Common Stock	1,200	1,885	600	1,013	872	86.1
# Of Common Stock Issues	33	55	21	44	11	25.0
Preferred Stock	75	306	225	345	(39)	(11.3)
# Of Preferred Stock Issues	3	9	5	9	------	------
Corporate Debt	1,457	4,298	1,867	3,785	513	13.6
# Of Corporate Debt Issues	22	57	19	36	21	58.3
MUNICIPAL FINANCING* (Gross New Issues)						
Total	4,007	8,328	4,049	8,339	(11)	(0.1)
Notes	1,843	3,248	1,546	3,142	106	3.4
Bonds	2,164	5,080	2,502	5,197	(117)	(2.3)
# of Bond Issues	211	510	288	597	(87)	(14.6)
Negotiated Bonds	1,150	2,687	1,113	1,985	702	35.4
Revenue Bonds	1,152	2,999	1,555	2,949	50	1.7

*Preliminary Figures

3

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	January 1980	Year-to-Date 1980	January 1979	Year-to-Date 1979
NET SALES*	8.6	8.6	(26.5)	(26.5)
NET PURCHASE OF COMMON STOCK*	(359.4)	(359.4)	(280.9)	(280.9)
NET PURCHASE OF OTHER SECURITIES*	(75.5)	(75.5)	120.9	120.9
MUTUAL FUND CASH POSITION	9.6	——	9.8	——

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	February 1980	February 1979	Percentage Change
MARGIN DEBT OUTSTANDING ($MILS)	12,460	10,790	15.5%
NET CHANGE IN MARGIN DEBT ($MILS)	640	40	——
% OF ACCOUNTS WITH EQUITY UNDER 40%	11	15	——

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Fourth Quarter 1979	Fourth Quarter 1978	Percentage Change 4th Quarter 1979 - 1978	Full Year 1979	Full Year 1978	Percentage Change 1979 - 1978
REVENUE						
SECURITIES COMMISSION INCOME	1,052	863	21.9	4,012	3,772	6.4
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	720	284	153.5	2.671	1,544	73.0
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	192	156	23.1	770	741	3.9
TOTAL REVENUE	3,155	2,175	45.1	11,264	8,824	27.7
TOTAL EXPENSES	2,916	2,187	33.3	10,164	8,140	24.9
NET INCOME BEFORE TAXES	239	(12)	—	1,100	684	60.8
PERCENT OF FIRMS SHOWING LOSS	25	47	—	—	—	—

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
The Quality of the New York Stock Exchange Marketplace in 1979	A sixteen page report by the Exchange's Quality of Markets Committee containing statistical information on volume price continuity, quotation spreads and trade matches at the exchange for 1979 as compared to previous years.	New York Stock Exchange March 6, 1980
The Death of What?	Article reporting on the strength of stocks on the American Stock Exchange. With action coming from individual investors as well as institutions, and new Value Index records set frequently, the author believes the action will spread to the big institutional-type issues.	Forbes February 18, 1980 p. 40
The State of the Securities Industry	Text of a speech delivered by Edward I. O'Brien, SIA President, to the Investment Analysts Society of Chicago on March 13, in which he analyzes trends in the securities industry and capital markets discernible at the start of a new decade.	Money Manager March 24, 1980
What Expensive Oil and a Big Trade Deficit will Mean for Japan in 1980	Interview with Hisao Kanamari, President of the Japan Economic Research Center.	World Business Weekly March 3, 1980 p. 5
Ready for VAT?	After examining the pros and cons of a value-added tax, the authors conclude that the Federal government should seriously consider imposing a VAT and simultaneously reducing other taxes substantially.	Financial Executive February 1980 p. 24
A Productivity Drop That Nobody Believes	Article raising questions about the validity of government figures on production. A significant part of the decline in the annual productivity growth figure is due to data showing a major deterioration in construction productivity, but most economists believe these data to be highly misleading.	Business Week February 25, 1980 p. 77

ITEM	DESCRIPTION	SOURCE
New Futures & Options Markets	The author proposes Futures and options markets in which values are tied to the Consumer Price Index. Such markets would replace real goods as an inflation hedge, thereby discouraging hoarding and encouraging capital investment. Three tables, one graph.	Financial Analysts Journal January/February 1980 p. 42
The Monetary Base as an Intermediate Target for Monetary Policy	A paper examining the nature of the monetary base, its relationship to the GNP, and its feasibility as a viable tool for short as well as long-term targeting. The study finds the monetary base to be less related to nominal GNP than are conventional monetary measures and thus unsatisfactory as a single money stock measure. Three tables, two charts.	Federal Reserve Bank of New York Quarterly Review Winter 1979-1980 p. 1
The Financial Markets: Current Developments	Overview of financial trends in the fourth quarter 1979. Provides detailed information on monetary aggregates, short-term and long-term interest rates, financial markets. Three charts.	Federal Reserve Bank of New York Quarterly Review Winter 1979-1980 p. 54

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Trends
AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

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REPORTING ON SEC/SBA STUDY

HIGHLIGHTS

1. This issue of Trends summarizes Initial Public Offerings of Common Stock: The Role of Regional Broker/Dealers in the Capital Formation Process, a research report jointly undertaken by the SEC and the Small Business Administration.

2. A major problem facing small business in the U.S. is the unavailability of equity financing. Between 1972 and 1978, initial public offerings (IPOs) of common stock declined from $2,051 million to $177 million, and were as low as $38 million in 1975.

3. The IPO volume for the first half of 1979, at $179 million, represents an improvement over 1974-78; however, this recovery trailed by far that for seasoned equity offerings.

4. In favorable markets, both IPO issue and issuer size tend to be greater, suggesting that larger issuers have access to financing sources -- bank credit, private placements, etc. -- not available to the very smallest companies.

5. Because their IPO investment banking clients tend to be larger, National Firms are more cyclical than Regionals in their IPO involvement. Nationals managed 83% of the IPO dollar volume involving issuers with gross revenues exceeding $25 million.

6. Regional firms are heavily committed to underwriting the stock of new, high technology companies. Between 1972 and the first half of 1979, Regional firms managed 79% of the IPOs of high technology companies.

Introduction

The languishing state of small business has recently attracted a great deal of attention from both the political and financial sectors. The high cost and/or unavailability of equity capital has been an integral part of small business' -- and, indeed, of the U.S. economy's -- problems. Initial Public Offerings of Common Stock: The Role of Regional Broker/Dealers in the Capital Formation Process is a report of the first stage of research jointly undertaken by the SEC Directorate of Economic and Policy Research and the Small Business Administration. Like the NASD's May 1979 Report, the SEC/SBA Report considers the interrelationship between smaller broker/dealers and small business in general. The SEC/SBA Report is distinguished by a wealth of information on initial public offerings (IPOs) covering the period from 1972 through the first half of 1979, that makes it an invaluable source for observers of the securities industry and markets.

While many earlier studies of IPOs, as the Report points out, concentrated on the efficiency of securities markets, the SEC/SBA Report provides detailed information concerning the issuers and underwriters themselves. The major objective of the Report is to establish a sound factual base on which decisions can be made rather than formulation of specific policy recommendations. In recognition of the importance of initial equity offerings to the economy and to the securities industry, this issue of Trends will attempt to summarize highlights of the SEC/SBA Report.

THE REPORT

The decline of the new issues business, a measure of which is provided by Table I, has prompted the SEC to take several steps recently. These include the introduction of the S-18 registration form, with its somewhat simplified requirements, and the increase from $500,000 to $1,500,000 of the maximum amount of securities issuable under Regulation A in one year. The SEC/SBA Report represents another undertaking in this area.

TABLE I

COMMON STOCK OFFERINGS BY PUBLICLY HELD CORPORATIONS AND BY IPO ISSUERS 1972 - 1979

(Millions of Dollars)

Year	Publicly Held Corporations 1/ 2/	Index (1972=100)	IPO Offerings 2/ 3/	Index (1972=100)
1972	$10,707	100	$2,051	100
1973	7,643	71	295	14
1974	3,976	37	42	1
1975	7,413	69	38	2
1976	8,305	78	128	6
1977	8,047	75	99	5
1978	7,956	74	177	9
1979 (6 mos.)	3,977	74	179	9
Totals	$58,024		$3,009	

1/ Amount of securities offered for sale, including IPO offering volume and offerings of closed-end investment companies.
2/ Includes both primary and secondary portions of offerings.
3/ Actual amount sold.

Source: Directorate of Economic and Policy Research
Securities and Exchange Commission

Although a falling off in new issues during the 1973-74 market downturn is understandable, the Report points out, the recovery in IPOs since then has not matched the recovery in total equity offerings. However, if utility offerings were netted out of the total equity figures, seasoned equity offerings would also have staged less of a recovery.

The Report is broken into four chapters: (1) A Review of Prior Research, (2) Transaction and Issuer Profile, which is the Report's most important contribution to the existing knowledge of small business financing, (3) Managing Underwriter Profile, and (4) Future Research Activity.

A Review of Prior Research

In its review of prior research, the SEC/SBA Report stresses the importance of three sources -- Congressional hearings, involving various committees and subcommittees, in 1977-78; the 1977 Report of the SBA Task Force on Venture and Equity Capital for Small Business; and the 1979 NASD Report of the Joint Industry/Government Committee on Small Business Financing.

The small business capital shortage quickly reduces to an equity capital shortage. The other available financing sources are either meaningless for most fledgling operations, as in the cases of depreciation and retention of earnings, or unavailable, in the case of long-term debt financing. The SEC/SBA Report's summary of prior research identifies five obstacles to small business equity financing that involve general economic conditions and two additional obstacles inherent in the structure of the securities industry.

The five macroeconomic obstacles include:

- The sluggish economy of recent years, characterized by high inflation and interest rates and a low level of profitability in real terms.
- Tax policies that have served as a disincentive to risk-bearing. Maximum effective capital gains taxes were as high as 49.2% in 1976-78. Corporate income taxes also reduce investor reward.
- Institutionalization of the securities markets and related legislative and regulatory measures, ERISA foremost among them, that have induced a sort of fiduciary hyper-caution.
- The emergence of alternative investment vehicles for risk capital, notably organized options and futures trading. The SEC/SBA Report does note, however, that some earlier studies suggest the new issue business was declining before the advent of organized options trading.
- Merger activity. Absorption by a larger corporation is an alternative to a stock offering for a small business in need of external financing.

The obstacles inherent in the structure of the securities industry are:

- Contraction of the securities industry. The number of NASD registered broker/dealers declined 37% from 1970 to 1978.

- Registration costs, which the NASD estimates increased 91% over the 1972-1978 period for IPOs.

Transaction and Issuer Profile

Chapter 2, containing information on issue and issuer size, tends to confirm the NASD Report's thesis that small business financing is mainly an activity of Regional firms. Regional firms, as defined in the SEC/SBA Report, managed 78% of the IPOs in the 1972 - 1st half 1979 period and 48% of the IPO dollar volume. Because Regional firms are likely to co-manage syndicates of which a National firm is lead manager, the role of Regional firms in IPO financing, as the Report acknowledges, is probably understated.

National firms, not surprisingly, tend to deal with larger issues and, hence, larger issuers. Their involvement in IPO financing is more cyclical than that of Regional firms. For example, Regional firms managed 60% of the IPO dollar volume in 1974 and only 20% in 1975, a year characterized by an improving market climate. Regional firms' share of IPO dollar volume went as high as 68% in 1977, another very poor year. The table below, which appears on page 26 of the SEC/SBA Report, points out differences in the IPO business of National and Regional firms.

TABLE II

ANNUAL IPO VOLUME AND AVERAGE OFFERING SIZE BY TYPE OF MANAGING UNDERWRITER

(Millions of Dollars)

			Average Offering Size[1]		
Year	Number of Issues	Gross Proceeds[1]	National Managing Underwriter	Regional Managing Underwriter	All Issues
1972	481	$1,974	$ 9.7	$2.5	$4.1
1973	83	291	7.9	2.2	3.5
1974	12	37	15.0	2.0	3.1
1975	6	34	13.5	1.8	5.7
1976	21	127	9.0	3.4	6.0
1977	33	96	7.8	2.2	2.9
1978	41	177	13.6	2.4	4.3
1979 (6 mos.)	29	179	12.0	4.0	6.2
1972-1979 Total/Average	706	$2,915	$ 9.8	$2.5	$4.1

1/ Includes both primary and secondary portions of IPOs.

Source: Directorate of Economic and Policy Research
Securities and Exchange Commission

Table III, compiled from data in the Report, supports the same conclusion. It is important to note the disparity between the average and the median figures for annual issuer revenues. The difference between the two is greatest relatively in 1974 and absolutely in 1975. A single or a few large issuers can distort the mean. These same large issuers are more apt to be the investment banking clients of National than of Regional firms, and the National firms' market share and the revenues of the average issuer both peak in the 1975-76 period.

TABLE III

ISSUE AND ISSUER SIZE AND NATIONAL/REGIONAL MARKET SHARE

(Millions of Dollars)

Year	Average Issue Size	Average Issuer Revenues	Median Issuer Revenues	Market Share* National Firms	Market Share* Regional Firms
1972	$4.1	$11.8	$ 5.2	52%	48%
1973	3.5	13.4	3.0	52	48
1974	3.1	9.3	1.8	40	60
1975	5.7	52.3	11.4	80	20
1976	6.0	29.4	12.5	71	29
1977	2.9	13.4	7.8	32	68
1978	4.3	15.7	8.8	54	46
1979 (6 mos.)	6.2	13.9	13.7	53	47

* Based on dollar volume managed.

Clearly, National firm participation and issue/issuer size are closely correlated. Moreover, IPOs sold on a best efforts basis were exclusively the business of Regional firms. Best efforts offerings are usually distributions of the stock of the smallest, riskiest issuers. The tendency of National firms' clients to avoid making IPOs in poor markets suggests either that these firms delay expansion plans or that they have access to alternative financing sources, including different forms of debt, that the smallest IPO issuers lack. The smaller companies may be more inclined to proceed with a dilutive initial public offering of common stock simply because it represents the only available means of financing.

There are qualitative as well as quantitative differences between the IPOs managed by National and Regional firms. Natural Resource and Transportation, Communication and Utility offerings, in terms of dollar volume, involve mainly National firms. Regional firms, in contrast, predominate in Agriculture, Service, and most strikingly, the so-called High Technology issues. The job-creating potential of small, high technology companies gives the Regional firms' strength in underwriting these issues a particular significance.

Information concerning issues sold under Regulation A is also provided in Chapter 2, although Regulation A issues have been kept separate from the IPO sample. The study examines Regulation A offerings for the first and fourth quarters of 1978, acknowledging that the latter period may provide an unrepresentative sample. The September 1978 increase in the Regulation A ceiling from $500,000 to $1,500,000 is matched by a 140% increase in the size of the average Regulation A issue over the same period. The Regulation A form is most frequently used by service and entertainment businesses and is a popular device for the financing of Broadway shows.

Managing Underwriter Profile

This section discusses the classifications of securities firms used in the analysis. National firms, for the purposes of the Report, were based on the SEC/SIA classifications: National Full Line, Large Investment Banking and Institutional. Regional firms included the five SEC/SIA Regional (New York City based and Regionals based outside New York City) categories. Summary income statement and balance sheet data were provided for the National Full Line, Large Investment Banking, and Regional firm categories.

The decline in the relative importance of underwriting revenues, an industry-wide phenomenon, is one that has paralleled the decline in commission revenues. The decline in IPO underwriting revenues, however, has been more marked than either -- down from 2.2% of gross revenues in 1972 to 0.1% in the first half of 1979, having been as low as 0.04% in 1975.

Related to the decline in IPO underwriting revenues is the degree of concentration in the new issues business, and the Report's conclusion on this score -- that the level of concentration has actually decreased since 1972 -- seems disputable. The measure of concentration selected, percentage of IPO dollar volume accounted for by the top 10% of managing underwriters, is rather misleading, since a single firm accounted for the top 10% in both 1974 and 1975, and only two firms represented the top 10% in the first half of 1979. The sample for all years after 1972 is too small to permit any meaningful conclusions to be drawn, and there is a problem in attempting any concentration measure in a business that experienced such a dramatic decline, particularly in the 1973-77 period. Concentration in the securities industry as a whole is a more satisfactory measure. Another alternative would have been percentage of the top 25% or 50% IPO underwriting firms that were Regionals.

Future Research Activity

This final chapter briefly describes the research that will constitute Phase II of the SEC/SBA joint study. Phase II will examine the research and market-making support Regional broker/dealers provide in the aftermath of an initial public offering, as well as providing greater detail concerning issuers and broker/dealers. Preliminary plans call for a final report for release in September 1980.

A survey of institutional investors published by SIA in March 1979 showed that most respondents had noted a decline in the liquidity of smaller capitalized stocks over the 1975-78 period. Information on the degree to which smaller companies are excluded from research coverage will prove useful and will complement the NASD Report findings concerning institutional investment in smaller companies.

Conclusion

The SEC/SBA Report represents a substantial contribution to the literature on the small business capital crunch, one that should be brought to the attention not only of the Trends readership but also of all those interested in the health of our capital markets. The Report's formidable statistical contents shed light on the interrelated fortunes of small corporations and Regional broker/dealers, also a concern of the 1979 NASD Report. The SEC/SBA Report will contribute to a shrewder assessment of the small business dilemma, and it is safe to assume that Phase II of the joint study will prove equally useful to regulators and industry professionals.

It is possible to have reservations about any attempt to measure concentration in a market that has declined as much as has that for initial public offerings, since, as noted above, 1972 was the last year in which the IPO sample was sufficiently large to support generalizations. In connection with this, it would be interesting to see IPO figures for the years 1968-71, if possible. It would seem very difficult to gain a full understanding of the new issues market of 1972-79 without reference to the four preceding years. Constraints on time and resources undoubtedly made it necessary to concentrate on a shorter period.

The small business capital crunch is one facet of the American economic malaise, of which the stagnant equity markets of recent years are both a symptom and a cause. A high cost of capital, declining profitability in real terms, risk aversion among investors, and a pro-consumption, anti-investment bias in tax policies afflict all segments of U.S. industry, but small business most of all. To effect any improvement in this situation, numerous measures are required, among them a modification of tax policies, imposition of fiscal restraint, and an easing of regulatory burdens. All of these measures are by no means focused exclusively upon small business as such. The problems of small business cannot be dealt with in a vacuum. The SEC/SBA study provides useful analysis of structural changes taking place in the securities industry and the impact of those changes upon other sectors of the economy that depend on the securities markets.

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Securities Industry Trends

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
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ADAPTING TO CHANGING MARKET CONDITIONS: A REVIEW OF 1979

HIGHLIGHTS

1. Considering the very turbulent market conditions in 1979, the securities industry's estimated after-tax return on equity of 16.1% was exceptionally good.

2. While revenues were soaring 27.5% over 1978, costs were also increasing at a rapid, although somewhat slower, pace -- 24.7%. Much of the dramatic rise in revenues last year was attributable to rising interest rates which were reflected in increased revenues from firm long positions and customer margin accounts.

3. The industry engaged in more sophisticated hedging strategies by employing short positions and using interest rate futures. Short positions as a percentage of long positions rose from 40% in the third quarter of 1978 to 68% at year-end 1979. This explains how the industry escaped relatively unscathed from the bond debacle of 1979's fourth quarter.

4. For the second consecutive year, the number of NYSE firms dealing with the public increased. More importantly, using one measurement of concentration, the relentless trend towards increased concentration was halted for the first time in years. The market share of the largest 25 firms fell from 71% of gross revenues and 69% of capital in 1978 to 70% and 68%, respectively, last year.

5. Reflecting the improved economic climate of the industry, equity capital was just under $4 billion at year-end 1979 after hovering around $3 billion for most of the 1970s. These figures indicate that capital can be attracted or retained in the securities industry so long as the risk-adjusted rate of return is adequate.

Introduction

The 1970's was a turbulent decade for the securities industry, characterized by severe fluctuations in securities prices, government-mandated structural changes, diversification, increased concentration and consolidation within the industry, and other developments. This series of traumas unfolded within a highly uncertain economic climate. The rate of inflation began to rise and the dollar was devalued several times in the early part of the decade; 1974-75 witnessed a severe recession which looks likely to be matched if not surpassed in 1980.

In terms of the macroeconomic environment, there were many negative developments last year. On a constant dollar basis, GNP grew less than 1% from the fourth quarter of 1978 to the final quarter of 1979. The rate of inflation rose dramatically, as reflected by the 13.3% increase in the Consumer Price Index, compared to a 9.1% increase in 1978. Energy prices soared in 1979 following a lull in price increases during the two previous years; the weighted-average OPEC contract price per barrel of crude oil amounted to $26.50 at year-end 1979, representing a price increase exceeding 100% from 1978. The upheaval in Iran cut back supplies of oil and bidding on the spot market drove oil prices well above the contract price.

The high rate of inflation and rising energy costs, among other factors, impacted negatively on savings, investment and productivity. By the fourth quarter of 1979, the personal savings rate fell to 3.4% and increases in capital goods expenditures remained almost constant from 1978 to 1979.1/ Productivity actually declined by 0.4% from the fourth quarter of 1978 to the fourth quarter of 1979.2/

Industry Developments

Despite this unsettling economic climate, the securities industry made an exceptionally good showing in 1979. The industry's after-tax return on equity amounted to 16.1%, the highest percentage since 1976. Gross revenues increased an impressive 27.5% from a year earlier. Part of this increase in revenues is attributable to the high stock market volume in 1979. NYSE average daily share volume increased from 28.6 million in 1978 to 32.2 million in 1979. More importantly, all of the major U.S. stock market indices increased notably in 1979, with a jump of 64% in the performance of the Amex Market Value Index, the most impressive gainer.

1/ Survey of Current Business, Volume 60, No. 1, January 1980, p. 21.

2/ Bureau of Labor Statistics News, Release #USDL 80-269 Friday, April 25, 1980, p. 7.

Other factors contributed even more to the substantial growth in securities industry gross revenues last year. Trading and investment "profits" and margin interest revenues led the surge by increasing 73% and 40%, respectively. The growth in trading and investment profits and margin interest revenues were mainly due to rising interest rates. 3/

Impressive revenue gains were also achieved in other product lines (See Table I). Particularly noteworthy were the increases in "other" activities both related and unrelated to securities activities.

TABLE I

Securities Industry Revenues, 1979

	($ Millions)	As a Percentage of Gross Revenues	Percentage Increase from 1978
Commissions	$4,012.4	35.6%	6.2%
Trading & Investment Profits	2,670.9	23.7	73.0
Margin Interest	1,651.5	14.7	40.7
Underwriting	769.5	6.8	3.8
Mutual Funds	75.6	.7	29.0
Commodities	436.0	3.9	24.3
Account Supervision	121.6	1.1	26.0
Research	12.3	.1	119.6
Other-Related	1,161.6	10.3	37.2
Other-Unrelated	352.6	3.1	48.7
Total	$11,264.0	100.0%	27.5%

Clearly, the industry continues to diversify both in activities related to the securities business and in other fields only remotely

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3/ Interest and dividend receipts on securities held by firms are included in investment and trading profits in the FOCUS Report, thereby biasing such profits upwards. Many in the industry agree that the practice of including interest and dividend receipts in reporting trading profits should end.

if at all, connected to what are generally considered traditional securities activities.

Expenses

While revenues were spurting 27.5% over 1978, expenses were also increasing at a rapid, although somewhat slower, pace -- 24.7%. Inflation strikes particularly hard at service industries because productivity gains are relatively limited. By increasing 57%, interest expense, in particular, placed upward pressure on industry costs. (See Table II.)

TABLE II

Securities Industry Expenses, 1979

	($ Millions)	As a Percentage of Gross Revenues	Percentage Increase from 1978
Floor Brokerage	$ 609.5	5.4%	2.0%
RR Compensation	1,906.2	16.9	17.7
Clerical & Administration Salaries	1,865.9	16.6	22.6
Communications	673.8	6.0	15.8
Occupancy & Equipment	424.3	3.8	12.0
Promotional Costs	248.0	2.2	32.6
Interest Expense	2,675.3	23.8	56.9
Partners & Stockholders' Salaries	439.4	3.9	11.7
All Other	1,321.4	11.7	13.8
Total Expenses	$10,163.8	90.2%	24.7%

Only floor brokerage and clearance and partners' and stockholders' salaries increased below the 13.3% rise in the CPI. Compensation to both sales and non-sales personnel jumped sharply as new employees were added to handle the increase in activity and additional time and effort were required from the existing labor force. Although commission revenues were increasing only 6% as compared to an 18% jump in RR compensation, it should not be concluded that all of this resulted from higher payout ratios. The changing business mix in 1979, particularly in principal activities, partly explains RR compensation rising relative to commission revenues. The dramatic rise in promotional expenses of 32.6% represents a commitment by securities firms to reach an expanding market for their basic products and the array of new products which have been added in recent years.

Diversification

Ten years ago, this industry resembled a one-crop economy and price competition was unknown. The dependence on commission business was troublesome for two reasons. First, fixed rates were on the way out. Second, retail investors were leaving the market in droves after the 1970 debacle and the combination of institutional discounting and the retail exodus made continued reliance on the commission business impossible for many firms. Diversification was thrust upon an industry faced with sagging demand for its basic product.

The speed with which the industry diversified has been nothing short of astonishing. In 1973, commission and underwriting activities accounted for just under two-thirds of gross revenues. Six years later, these product lines contributed only slightly more than 40% of gross revenues. The drop in the relative importance of commission revenues has been from 55% in 1973 to under 36% last year. Recent attempts to diversify are mainly reflected in the revenue growth of other activities both related and unrelated to the traditional securities business.

A combination of fixed costs, volatile revenues, and exposure to market fluctuations has made the industry's earnings performance look like a roller coaster. The industry's first stab at diversification led firms to act as principal rather than agent, thereby assuming the risk of fluctuations in the value of securities. Diversification is meant to lower, not increase, risk so these early moves were unsuccessful.

As retail investors shifted funds from stocks and other investments, securities firms followed them in pursuit. Over time, the industry learned to seize the initiative and supply products to meet changing customer needs. Firms are finding that one distribution system can sell real estate, insurance, estate planning and tax shelters, as well as stocks and bonds.

The industry has learned to use more sophisticated hedging strategies through the growing use of interest rate futures and shorting securities. These strategies explain how the industry escaped relatively unscathed (pre-tax profits of $239 million) from the fixed income rout of 1979's fourth quarter as compared to the fourth quarter of 1978 (pre-tax losses of $11 million). Furthermore, whereas 25% of the NYSE firms doing business with the public incurred losses during last year's fourth quarter, this compares favorably to the 47% with losses during the fourth quarter of 1978.

Performance Measures

Return on Equity (ROE) is the most important measure of a firm's performance, and the industry's 16.1% ROE for 1979 -- the highest since 1976 -- is an encouraging sign. It was not a case of selective prosperity, for every category included in Table III significantly upped its ROE from 1978 levels.

Table III

After-Tax Return on Equity, by Firm Category

	1973	1974	1975	1976	1977	1978	1979
All Firms	(3.0)%	0.7%	16.6%	17.6%	6.9%	10.9	16.1%
National Full Line	3.4	2.2	14.6	15.1	5.4	11.1	13.0
Lg. Invest. Banking	(5.3)	5.3	20.4	22.2	8.4	8.3	19.4
Regionals Based Outside NYC	2.9	(1.5)	16.6	16.8	7.8	12.8	13.9
NYC Based Regionals	2.4	1.6	19.3	17.3	7.7	15.3	20.5
Traders & Mkt. Makers	(26.8)	(30.0)	13.4	22.3	8.1	11.6	18.8

It is interesting that the NYC Based Regionals, the most commission-oriented category, ranked first in ROE, while Large Investment Banking firms, the least commission-oriented group, ranked second. Clearly, a variety of business mixes and strategies can lead to a favorable ROE.

Profit margin, an important determinant of ROE, highlights differences between firm categories. Firms in more capital-intensive lines of business have wider profit margins as a rule. The trend in profit margins over the past seven years, shown below, also illustrates dramatic changes in the securities business.

Table IV

Profit Margin, by Firm Category

	1973	1974	1975	1976	1977	1978	1979
All Firms	(1.8)%	0.4%	7.1%	7.4%	3.2%	4.0%	5.3%
National Full Line	1.8	1.1	6.2	6.0	2.3	3.6	3.8
Lg. Invest. Banking	(4.4)	3.4	10.1	10.7	4.8	3.9	6.6
Regionals Based Outside NYC	1.4	(0.6)	5.5	5.5	2.9	4.2	4.4
NYC Based Regionals	1.3	0.7	6.8	6.3	3.0	4.7	6.0
Traders & Mkt. Makers	(66.8)	(54.1)	10.0	17.4	9.7	12.9	18.3

The ROE in 1979 was nearer its 1976 level than was profit margin. This can be explained in part by the increasingly competitive nature of the business. Diversification has brought more securities firms into different areas of the business, thereby heightening competition. The erosion of the previous distinction between firms emphasizing retail versus institutional distribution is a case in point.

In addition, securities firms are facing increasing competition from different types of financial intermediaries.

Capital turnover, another performance measure, should be used with some caution. It is a ratio of gross revenues to total capital (equity plus subordinated debt). As such, it measures the efficiency with which a firm turns over its capital. What appears to be increased efficiency may in some cases result from growth in interest-earning assets that exceeds growth in a firm's capital base. Interest-earning assets, it should be remembered, can at times incur a negative carry.

A high capital turnover ratio may derive from the attempt to maximize revenues rather than net income. Analysts of the securities industry have repeatedly criticized the revenue-maximizing emphasis of recent years. This market share philosophy, by no means universal, is in part a legacy of fixed rates and in part a product of the "survive the current shakeout" mentality.

Table V

Capital Turnover Ratio

	1973	1974	1975	1976	1977	1978	1979
All Firms	1.25	1.35	1.75	1.88	1.74	2.14	2.39
National Full Line	1.46	1.52	1.83	2.06	1.95	2.47	2.67
Large Invest. Banking	0.95	1.23	1.63	1.73	1.47	1.69	2.34
Regionals Based Outside NYC	1.47	1.58	2.13	2.28	2.07	2.41	2.54
NYC Based Regionals	1.27	1.36	1.85	1.95	1.83	2.27	2.39
Traders & Mkt. Makers	0.32	0.40	1.00	1.02	0.67	0.75	0.87

For most of the years shown above, firms in the more capital-intensive lines of the business had lower capital turnover. The pronounced turnover increase for Large Investment Banking firms, a heavily capital-intensive group, is due to the high rates at which interest accrued on long positions in 1979 and to the market volatility which benefitted short sellers. Traders & Market Makers, the least agency-oriented of all categories, had the lowest turnover.

Comparison of 1979 figures with those for 1976, the most recent cyclical peak, indicates a shift in business mix and intensified competition for the industry. A comparison of the very different macroeconomic conditions prevalent in those two years leaves no doubt that industry management is becoming more adaptable and innovative.

Earnings Volatility

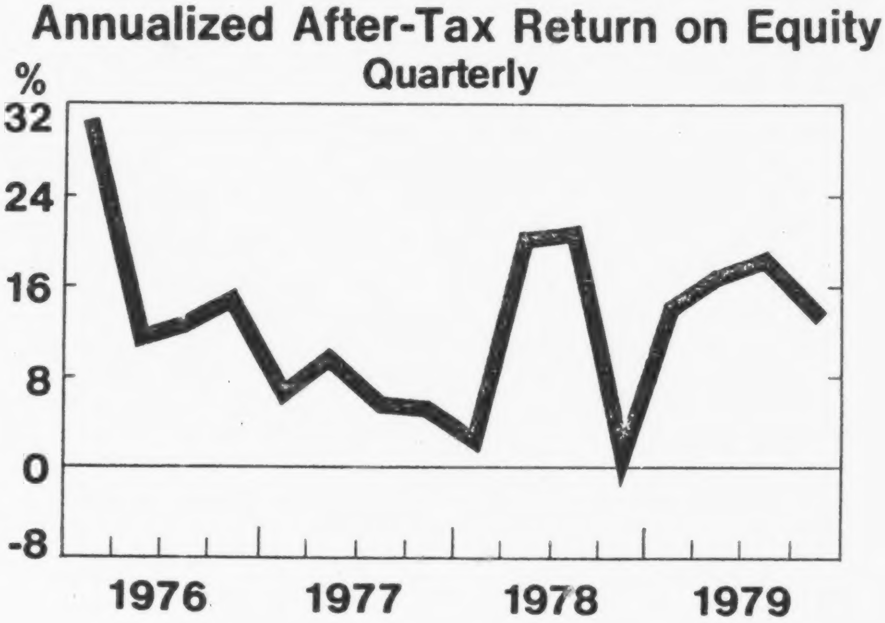
The securities industry experiences a higher degree of earnings volatility than does U.S. industry in general, as the table on the following page indicates. This earnings volatility is due to a combination of fixed costs, very cyclical revenues and securities price and interest rate fluctuations. At least in the short run, a firm has the same branch system in place whether volume is 25 million shares or 50 million shares, and variable costs are relatively low. Periodic bursts of inflation have greatly increased interest rate and securities price volatility and the industry's risk exposure.

Table VI

After-Tax Return on Equity

	1973	1974	1975	1976	1977	1978	1979
Securities Industry	(3.0)%	0.7%	16.6%	17.6%	6.9%	10.9%	16.1%
All Manufacturing	14.9	15.2	12.6	15.0	14.8	16.0	18.4

The industry's strong 1979 showing could be interpreted as simply another cyclical upswing. The chart below, however, suggests the industry succeeded in lessening earnings volatility last year:



It is interesting that the industry's earnings volatility should decline as the capital markets become increasingly turbulent. That earnings should stabilize at a relatively high level is an especially encouraging sign. To a great degree, we believe that more sophisticated hedging strategies are responsible for this improvement.

Consolidation and Concentration

In response to the greater profit opportunities available in 1979, the number of NYSE firms doing a public business increased from 366 at year end 1978 to 374 twelve months later. This is the second consecutive annual increase in number of firms. Historically, the number of firms has tended to increase or decline in response to market conditions. A conspicuous exception is the continued falling off experienced during the strong 1975-76 recovery. This decline in the face of increased prosperity was partly a lagged result of the 1973-74 bear market and partly due to Mayday.

Number of NYSE Firms Doing a Public Business
(At Year End)

1973	1974	1975	1976	1977	1978	1979
444	422	404	379	364	366	374

A more clouded picture emerges when the level of industry concentration is taken into account. Industry concentration both increased and decreased during 1979 because the market share of the largest 10 firms continued to increase, while that of the largest 25 firms fell slightly.

Table VII

Market Share of Largest Firms, 1973-1979

Gross Revenues

	1973	1974	1975	1976	1977	1978	1979
Top 10	33.6%	38.2%	40.1%	41.6%	41.4%	44.5%	48.4%
Top 25	47.8	56.0	58.1	60.3	62.4	70.7	70.1

Commissions

	1973	1974	1975	1976	1977	1978	1979
Top 10	25.7%	29.2%	32.8%	34.6%	33.7%	37.9%	39.1%
Top 25	42.3	48.0	52.8	53.9	55.4	64.8	63.6

Table VII (Cont'd)

Market Share of Largest Firms, 1973-1979

Year End Total Capital

	1973	1974	1975	1976	1977	1978	1979
Top 10	35.0%	40.8%	42.5%	43.8%	43.5%	44.9%	46.8%
Top 25	50.2	58.0	59.5	61.3	64.3	68.9	67.7

The increased level of concentration for the Top 10 firms can be explained by the occurrence in 1979 of two of the largest mergers in Wall Street history. In contrast, merger activity during 1976-77 was greater among the so-called second 15 firms. That Top 10 market share and number of firms should both increase is often cited as proof of the emergence of a two-tiered industry structure in which large multi-line and smaller specialty firms both find a market. Discounters are the most publicized, though by no means the best documented, type of smaller specialty firm.

Balance Sheet Analysis

The explosive growth of industry revenues has been paralleled by and closely related to the burgeoning of industry assets. Balance sheets can give an even better sense than do income statements of the industry's changing business mix, increased risk, and growing resemblance to other types of financial intermediary. The 72% asset increase between year-end 1977 and year-end 1979, shown on the balance sheet below, is mainly attributable to the growth in three asset accounts -- customer receivables, long positions and, most dramatically, securities purchased under agreements to resell. While liabilities, of course, increase in response to asset increases, increases in particular asset and liability accounts move closely in tandem, as in the case of customer receivables and payables.

Customer receivables, the account which includes the margin loans made to customers, had declined to third place on the asset side of the balance sheet by year-end 1979, despite a 33% increase over two years. This is a relatively low-risk asset, since the loans to customers are collateralized by the securities and commodities positions held on margin. Recent developments have drawn attention to the volatility of commodity positions used as collateral, but, in the aggregate, commodity-related margin loans are a small percentage of the total. Customer receivable accounts are, in effect, a loan portfolio, just as customer payables are a short-term source of funds.

Securities purchased under agreements to resell (reverse repos) represent the largest asset account and, by a wide margin, the fastest growing over the last two years. Reverse repos, in fact, were not even broken out from long positions until the

Table VIII

Securities Industry Balance Sheet
(millions of dollars, end of quarter)

Assets	4Q 1977	4Q 1978	3Q 1979	4Q 1979
Cash	797	984	1,529	1,775
Broker Receivables	4,982	5,109	6,766	7,228
Customer Receivables	13,537	15,868	19,239	17,956
Securities Purchased under Agreement to Resell	8,187	14,018	20,694	24,244
Long Positions	13,799	15,238	22,600	20,161
Other Assets	2,319	2,685	3,141	3,499
Total Assets	43,621	53,902	73,969	74.863

Liabilities				
Bank Loans Payable	11,295	9,460	9,633	8,535
Securities Sold under Repurchase Agreements	10,584	16,306	26,115	23,851
Broker Payables	4,891	4,676	6,273	6,736
Customer Payables	5,099	7,202	10,404	10,975
Short Positions	3,980	6,610	10,763	13,705
Other Liabilities	3,839	5,258	5,876	6,085
Subordinated Liabilities	759	963	1,002	1,035
Total Liabilities	40,447	50,475	70,066	70,922
Owner's Equity	3,174	3,427	3,904	3,940
Total Liabilities and Owner's Equity	43,621	53,902	73,969	74,863

first quarter of 1976, at which time they amounted to $1.8 billion, only 7% of the $24.2 billion in assets the industry held at that time. Unlike ordinary principal transactions, however, reverse repos do not expose a firm to the risk of securities price fluctuations, for the resale price is pre-arranged and the firm earns a stated rate of interest for owning the securities.

The rise of reverse repos on the asset side has been matched by the growth of securities sold under agreements to repurchase (repos) on the liabilities side. Repos, amounting to $23.9 billion at year-end 1979, were nearly double the size of the next largest industry liability. By matching repos and reverse repos of like maturity, firms can earn an interest spread while hedged against market fluctuations. The decline of bank loans payable in both relative and absolute terms has accompanied the rise of this alternative source of financing.

Long positions in securities and commodities are the second largest asset account and by far the riskiest. Institutionalization of the markets and the trend towards bonds among institutions during the 1970s led the industry into serving as principal rather than agent. The industry's fourth quarter 1978 experience was a good example of what can befall an industry carrying roughly four times its own net worth in inventories -- volatile inventories, at that.

While long positions were 50% or $7.5 billion higher in the third quarter 1979 than they had been one year earlier and interest rate rises even more pronounced, the industry was far better hedged than it had been a year earlier. Money market funds are frequently cited as evidence that individuals are learning to live with inflation; hedging indicates that the securities industry is also learning. A useful measure is short positions as a percentage of long positions. Between the third quarter 1978 and 12 months later, this figure rose from 39.8% to 47.6% and was as high as 68.0% at year-end 1979. Moreover, the advent of organized trading in interest rate futures has improved the industry's ability to control risk.

The industry's capital, both equity and total capital, increased markedly in the period covered by the balance sheet above, although asset growth was faster yet. After hovering around $3 billion for most of the past decade, equity capital began to increase in mid-1978 and was just under $4 billion at year-end 1979. Subordinated debt increased similarly, although it is hard to say how much of this incremental subordinated indebtedness was incurred mainly -- or solely -- to comply with net capital requirements.

Conclusion

The securities industry made the most -- or a great deal -- of poor economic conditions in 1979. Their success was due mainly to a combination of soaring interest rates, high volume and hedging dexterity. The trend towards concentration not only slowed but, under one important measure, reversed itself. Moreover, equity capital increased by 15% over the year.

A criticism that has been heard with bewildering frequency is that the securities industry has failed to attract and retain sufficient capital to meet the requirements of an increasingly capital-intensive business. Undercapitalization, this argument runs, invites competition from better capitalized financial institutions. While the recent growth of industry capital may eliminate this criticism, it does not expose the misconception on which it is based.

Simply put, retention of capital in an industry that fails to produce an acceptable risk-adjusted rate of return is not possible over the long term, a situation tending to discourage additional competitors rather than encouraging them to leap across regulatory bounds to participate in the business. The rise in industry capital and number of firms with a reduction in concentration during 1979 demonstrates the availability of capital where returns are sufficient. With the blurring of distinctions between different financial intermediaries, we can expect an intensification of efforts by banks, insurance companies and others to gain entry into the more lucrative product lines available from the securities industry. However, these "intruders" are likely to find better managed, stronger capitalized and more formidable competitors than was true a few years ago.

Jeffrey M. Schaefer Vice President and Director of Research	Timothy Y. Smith Assistant Director of Research

SECURITIES INDUSTRY STATISTICS

VOLUME

	April 1980	YEAR-TO-DATE 1980	April 1979	YEAR-TO-DATE 1979	% CHG. Y-T-D 1980-1979
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	32.1	43.6	31.0	28.5	53.0%
AMEX (MILS.)*	3.4	6.3	4.3	3.6	75.0
NASDAQ (MILS.)*	13.3	22.0	14.7	12.2	80.3
REGIONAL EXCHANGE (MILS.)*	4.2	5.2	3.8	3.2	62.5
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	19896	117208	17859	68659	70.7
AMEX (MILS.)	1437	10579	1412	4989	112.0
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	5257	24671	5094	18530	33.1
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	8390	44558	10755	38376	16.1
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	29.7	29.8	25.4	26.0	14.6
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	3202	16033	2541	10407	54.1
AMEX OPTIONS	1835	9020	1171	4764	89.3
COMMODITY	6189	25665	5696	22945	11.9

MONTHLY AVERAGE

YIELDS

(MONTHLY AVERAGES)

	April 1980	April 1979	Basis Point Change
BOND BUYER INDEX (20 BOND)	8.63	6.29	234
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	12.04	9.38	266
Baa CORPORATE	14.19	10.33	386
RATIO Aaa CORPS. TO Baa CORPS.	.85	.91	---
MUNICIPAL BOND YIELDS (MOODY'S)	7.95	5.80	215

PRICES

(END OF MONTH)

	April 1980	April 1979	Percentage Change
DOW JONES INDUSTRIALS	817.06	854.90	(4.4%)
STANDARD & POOR'S 500	106.29	101.76	4.5
NYSE COMPOSITE	60.36	57.36	5.2
AMEX MARKET VALUE INDEX	253.37	184.18	37.6
VALUE LINE COMPOSITE	112.02	110.71	1.2
NASDAQ COMPOSITE	139.99	133.82	4.6

UNDERWRITING
(DOLLARS IN MILLIONS)

	March 1980	Year-to-Date 1980	March 1979	Year-to-Date 1979	%Change March 1980 March 1979	%Change Y- T- D
CORPORATE FINANCING (Gross New Issues)						
Total	3,241	9,731	2,020	7,163	60%	36%
Competitive	401	1,334	205	1,452	96	(8)
Negotiated	2,840	8,397	1,815	5,712	56	47
Common Stock	740	2,625	289	1,302	156	102
# Of Common Stock Issues	36	91	18	62	100	47
Preferred Stock	282	588	----	345	---	70
# Of Preferred Stock Issues	7	16	-----	9	---	78
Corporate Debt	2,219	6,518	1,731	5,516	28	18
# Of Corporate Debt Issues	20	77	20	56	0	38
MUNICIPAL FINANCING* (Gross New Issues)						
Total	4,043	12,709	5,879	14,219	(31)	(11)
Notes	1,788	5,190	1,354	4,496	32	15
Bonds	2,255	7,519	4,525	9,723	(50)	(23)
# of Bond Issues	172	716	382	965	(55)	(26)
Negotiated Bonds	1,202	4,082	2,545	4,530	(53)	(10)
Revenue Bonds	1,346	4,478	3,398	6,347	(60)	(29)

*Preliminary Figures

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	March 1980	Year-to-Date 1980	March 1979 1979	Year-to-Date 1979
NET SALES*	(200.8)	(454.0)	(191.8)	(392.6)
NET PURCHASE OF COMMON STOCK*	(33.9)	(880.1)	(247.8)	(845.1)
NET PURCHASE OF OTHER SECURITIES*	92	(66)	201.9	195.5
MUTUAL FUND CASH POSITION	10.9	---	9.5	---

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	April 1980	April 1979	Percentage Change
MARGIN DEBT OUTSTANDING ($MILS)	11,140	11,220	(.71%)
NET CHANGE IN MARGIN DEBT ($MILS)	(600)	350	---
% OF ACCOUNTS WITH EQUITY UNDER 40%	15	13	---

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Fourth Quarter 1979	Fourth Quarter 1978	Percentage Change 4th Quarter 1979 - 1978	Full Year 1979	Full Year 1978	Percentage Change 1979 - 1978
REVENUE						
SECURITIES COMMISSION INCOME	1,052	863	21.9	4,012	3,772	6.4
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	720	284	153.5	2,671	1,544	73.0
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	192	156	23.1	770	741	3.9
TOTAL REVENUE	3,155	2,175	45.1	11,264	8,824	27.7
TOTAL EXPENSES	2,916	2,187	33.3	10,164	8,140	24.9
NET INCOME BEFORE TAXES	239	(12)	-----	1,100	684	60.8
PERCENT OF FIRMS SHOWING LOSS	25	47	-----	-----	-----	-----

SOURCE: FOCUS REPORT X-17A-20

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Two for the Price of One	Two-page summary of the tax bill which will impose a capital gains tax on the sale, by foreigners, of U.S. real estate, but will also exempt foreigners from the withholding tax on U.S. portfolio investments.	Forbes April 14, 1980 p. 116
A Growing Commitment to Foreign Securities	Results of a survey on investment in foreign securities by pension funds. Such investments are on the rise, particularly by the larger funds. Excerpts from five interviews help explain why.	Institutional Investor April 1980 p. 95
The Search for an Alternative to the Dollar	Examination of the possible replacements if the dollar is ousted as the primary reserve currency. Most experts predict a multicurrency reserve-assets system, in which the dollar's role will be large but not overwhelming.	Institutional Investor April 1980 p. 33
The Squeeze on the D-Mark	Overview of banking in West Germany details the Bundesbank's effort to deal with declining productivity and rising inflation, as well as giving a brief biography of the Central Bank's new president. It also examines the economic power of the banks, the power struggle between the various groups, and the special problems of foreign banks in Germany.	World Business Weekly June 2, 1980 p. 29
OPEC Cuts Wages	Brief article comparing real wages and productivity in Japan, West Germany, Britain, and the United States. Four graphs.	Economist April 26, 1980 p. 58
The Market Still Knows Best	Using a simplified country risk model and a naive model (which assumes market participants use only the current spread relationships in loan portfolio decisions), the author shows why the market's assessment of risk will out-perform that of an analyst. Five tables.	Euromoney May 1980 p. 121

ITEM	DESCRIPTION	SOURCE
Twenty-Five Years of Change in the Fortune 500	An analysis of changes of the 500 over the years and a report on some of the companies with the best and worst records. Of the original 500, only two remain; 932 companies have appeared at one time or another.	Fortune May 5, 1980 p. 88
Why Venture Capital Could Dry Up	One-page article briefly detailing how two proposed government regulations could block the flow of pension-fund money to venture-capital firms. Under a rule proposed by the Labor Department, a venture-capital firm's assets would be considered as assets of the pension plan and all such assets would have to meet a variety of ERISA requirements. The second rule, proposed by the SEC, would require venture capitalists to invest only in companies whose shares were not publicly traded and that had assets below specified levels.	Business Week April 14, 1980 p. 105
America's Small Business Economy: Agenda for Action	Two-part report on 1) the commission's findings on and goals for the small business economy, and 2) the recommendations made by the White House Conference on Small Business. Areas dealt with include: capital formation and retention, inflation, government regulation and programs, and international trade. 128 pages including 8 appendices.	White House Commission on Small Business April 1980
Arab Banking Survey	A series of twelve articles overviewing the structural problems in the Arab economies, the development of the Arab banking systems, the direction of Arab investments, and the new problems facing the oil producers.	Euromoney April 1980 p. 93

JUDITH S. WILLINGHAM

Securities Industry

Trends

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

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Volume VI Number 6 July 2, 1980

CUTS, REALIZATIONS AND CAPITAL GAINS TAX REVENUES

HIGHLIGHTS

1. It appears that higher capital gains realizations and related tax receipts generated by the 1978 capital gains tax reduction may offset most of the initial receipts lost by lowering the effective tax rates on capital gains. This suggests that the cost of reducing U.S. capital gains taxes can be considerably reduced by higher realizations.

2. Increases in capital gains realizations due to the capital gains tax cut are currently projected at $8 billion in 1979 and 1980 each. These estimates coincide with the experience of market specialists that investors of all kinds are realizing more long-term capital gains.

3. A study of the Shell Oil acquisition of Beldridge Oil Company is one example of the influence of the capital gains tax cut on investment decisions. While by no means the sole factor considered, the capital gains tax reduction played an important role in the decision of shareholders to accept cash payments.

4. Research indicates that cash tender offers rose to almost $11 billion in 1979, up from $5.4 billion in 1978. Most of this increase was received by individuals and is another indication of the increased willingness to realize long-term gains.

Introduction

The 1978 capital gains tax reduction has led to developments of significance for individual investors and for the future direction of U.S. tax policy.

The Treasury Department's current projections of capital gains and related tax receipts reveal that, based in large part on the tax cut itself, much higher levels of realizations were reached in 1979 than expected and even higher totals are estimated for 1980. Nevertheless, analysis of the latest data indicates that the Treasury Department is still seriously underestimating the tax receipts that will be generated by higher capital gains realizations in 1979 and 1980. It now appears that higher realizations induced by the 1978 changes may offset most of the initial receipts lost to lower tax rates. This is an important implication for the future: the cost of reducing U.S. capital gains tax rates -- still the highest among the major industrialized countries -- can be considerably reduced by higher realizations.

Furthermore, lowering capital gains tax rates has exerted a powerful positive leverage on the equity investment process. Under adverse economic conditions, a range of encouraging results have materialized -- higher equity values, more venture capital, more equity capital for rapidly growing companies and increasing total common stock offerings. All of these developments also add to tax receipts. Further, the removal of tax deterrents to individual investment may be much less costly and much more productive than assumed by opponents of capital gains tax reductions.

Realization of Capital Gains

Investment analysts have long believed that when capital gains tax rates are raised significantly, as in 1969 and 1976, the realization of capital gains is inhibited. This "lock-in" effect restricts the mobility of capital. Conversely, when capital gains tax rates are reduced from high levels, realization of capital gains should increase, unlocking capital so that it can flow to the most productive uses.

An understanding and recognition of the relationship between realizations and tax rates is crucial in estimating capital gains tax revenues. If changes in capital gains taxes are analyzed on only a static basis, two distortions result. First, the cost of lowering such taxes is exaggerated. Second, the exaggerated cost is translated into a special tax benefit for the upper income groups.

When a reduction in capital gains taxes was originally proposed in April 1978, the Treasury Department's opposition was based on its "cost" of $2.2 billion and the assumption that "Over four-fifths of the benefits would go to persons with incomes near $100,000." At the same time, the Treasury Department attacked proponents of the capital gains tax reduction for assuring "that reducing the maximum capital gains tax rate would generate a very sharp rise in realized capital gains..." The Department claimed "that realized gains fluctuate greatly from year to year, with the impact of changes in the economy easily swamping the effects of tax changes."1/ Later in 1978, when measures to reduce capital gains taxes were considered by the Senate Finance Committee, the Treasury Department finally conceded that a significant reduction of capital gains tax provisions would bring added realizations that could partially offset the revenue loss created by the lower rates.

Since the 1978 capital gains tax reduction, there has been great interest in determining what effect that tax measure has had on (1) realization of capital gains, (2) related tax receipts, (3) equity values, and (4) the ability of all companies to raise new or additional equity capital. Recently, the Treasury Department released a table (see page 4) giving historical data for total capital gains, taxes paid on capital gain income and the related effective tax rate.

For analytical purposes, the table suffers from several significant defects. First, the column entitled "Total Gains" includes "net long-term gain in excess of short-term loss plus short-term capital gain." Adding short-term capital gain to net long-term gain obviously makes an accurate determination of the impact of changes in long-term capital gains tax rules on realizations almost impossible. In addition, figures for 1978 through 1980 are estimates whereas figures for prior years are actual results. This table, however, contains the only data now publicly available on capital gains tax realizations and related tax receipts.

The Treasury does not have actual data on the effect of the 1978 law changes on realizations. The forecast of capital gain realizations currently used by Treasury assumes that the 1978 tax law changes will increase capital gain realizations by about $8 billion in both 1979 and 1980. The $8 billion increase in realizations will yield nearly $0.9 billion in additional income taxes from capital gains in each of the two years according to the effective rates assumed by the Treasury.

1/ Letter of W. Michael Blumenthal, Secretary of the Treasury, to members of the House Ways and Means Committee, May 11, 1978. The "cost" was based on 1978 income levels and included corporate rate reductions.

TABLE I

Total Capital Gains and the Effective Tax Rate on Capital Gains for Returns with Net Capital Gains Only
(Individual Only)
(1955-1980)

Year	Total gains 1/	Taxes paid on capital gain income	Effective tax rate
	(........... $ billions	............)	(... percent ...)
1955	$ 9.9	$1.2	12.0%
1956	9.7	1.1	11.8
1957	8.1	0.9	11.1
1958	9.4	1.1	11.1
1959	13.1	1.6	11.8
1960	11.7	1.4	11.6
1961	16.3	2.0	12.4
1962	13.5	1.6	11.8
1963	14.6	1.7	11.9
1964	17.4	2.2	12.7
1965	21.5	2.8	13.1
1966	21.3	2.7	12.8
1967	27.5	3.9	14.0
1968	35.6	5.2	14.5
1969	31.4	4.4	14.1
1970	20.8	3.0	14.6
1971	28.3	4.3	15.2
1972	35.9	5.6	15.7
1973	35.8	5.3	14.9
1974	30.2	4.3	14.3
1975	30.9	4.5	14.4
1976	39.0	6.2	15.9
1977	45.9	7.3	15.8
1978 2/	48.0	7.4	15.4
1979 2/	59.3	6.4	10.8
1980 2/	63.9	7.0	11.0

Office of the Secretary of the Treasury February 13, 1980
Office of Tax Analysis

1/ Net long-term gain in excess of short-term loss plus short-term capital gain.

2/ Estimates.

Projections that the capital gains tax cut will increase capital gain realizations by $8 billion in both 1979 and 1980 are very encouraging. This coincides with the experience of market specialists that investors of all types are realizing more long-term capital gains. As an example, a case study of the sale of Belridge Oil is presented below.

* * *

BELRIDGE OIL COMPANY

A Case Study in How Lower Capital Gain Tax Rates Add to Tax Receipts

In 1979, Shell Oil Company acquired Belridge Oil Company for $3.65 billion in cash. Mobil Corp. and Texaco each had minority interests in Belridge; the balance of the company was owned by about 2,000 individual shareholders -- many of whom were descendants of the families who founded the company -- and small family companies. These shareholders received a total of $2.4 billion.

It would be wrong to assume that the willingness of the Belridge shareholders to sell to Shell Oil was predominantly influenced by the 1978 capital gains tax reduction. No transaction of this size and significance could be influenced by tax matters alone. On the other hand, a spokesman for Shell Oil believes that the capital gains tax reduction did greatly influence the way in which the Belridge stockholders -- particularly, the individual stockholders -- elected to receive payment for their shares. They were offered a choice between immediate payment in cash and payment by means of installment notes that would result in deferred payments over a period of 10 years. Virtually all the individual shareholders elected to receive payment in cash rather than notes; Shell Oil issued only several million dollars of installment notes. The willingness of the individual stockholders to accept payment in cash rather than to receive installment notes will greatly accelerate the related tax payments to the Federal Government.

We might add that as part of Shell Oil, Belridge's oil production has already improved. The capacity of Shell Oil to add technical people, to utilize its water-flooding experience, and to invest heavily in the Belridge properties will expand its oil production very substantially over the next few years.

The acquisition of Belridge Oil by Shell was the largest cash acquisition of 1979. Other research indicates that acceptance of cash tender offers rose to $8.5 billion in 1979 (excluding $2.4 billion paid to individual owners of Belridge Oil), up from $5.4 billion in 1978.2/ Most of the total increase was received by

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2/ Based on data developed by W. T. Grimm & Co., and the research of Rudolph Hauser of Oppenheimer & Co., Inc.

individuals and represents long-term capital gains. Such a big jump suggests that the Treasury Department's estimate that total capital gains increased by $11.3 billion in 1979 may be on the low side.

* * *

Effective Tax Rates

The estimates of added tax receipts due to these realizations of $900 million in 1979 and 1980 each are equally interesting. These revised estimates are a far cry from the earlier Treasury projections of increased tax revenues from capital gains realizations of $573 million in 1979 and $535 million in 1980.[3] Despite this upward revision, however, there remains a question as to whether the Treasury Department is still underestimating the impact on tax revenues of the newly projected higher realizations.

To estimate 1978, 1979 and 1980 capital gains tax receipts, the Treasury Department's Office of Tax Analysis has estimated: (1) capital gains realizations; and (2) effective tax rates paid on those realizations. The Treasury's determination of effective tax rates for 1979 and 1980 gives rise to some reservations.

The 1978 changes in capital gains tax provisions brought the taxation of long-term capital gains fairly close to pre-1970 levels. In 1967 through 1969, the effective tax rate on capital gain income averaged 14.2%. Thus, it seems reasonable to assume that 1979-1980 effective tax rates should be in line with those of the late 1960s, if not higher. After all, as inflation has pushed taxpayers into higher tax brackets, the taxable portion of a long-term capital gain has been taxed at progressively higher rates.

If the applicable effective tax rate for 1979 was about 14% -- in line with the experience of the late 1960s, taxes paid on capital gain income in 1979 would be $8.3 billion, up from $7.4 billion in 1978. In 1980, based on a 14% effective tax rate, such taxes would increase to over $8.9 billion.

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[3] The final 1978 revenue estimates of changes in capital gains tax provisions called for a net revenue loss of $2.27 billion in 1979 and a net revenue loss of $2.46 billion in 1980. As an offset to these figures, there were estimated "tax increases from induced capital gains realization" of $573 million in 1979 and $535 million in 1980. These figures exclude the effects of corporate capital gains tax changes and the "one-time exclusion of gain or sale of residence."

In comparing effective tax rates from 1967 through 1969 with those estimated for 1979-1980, the Treasury noted:

> "The high effective tax rates that held from 1967 through 1969 were due to the unusual distribution of capital gain income. In these three years, nearly 36% of capital gain income was realized by individuals with an adjusted gross income over $100,000. For the years 1955 through 1966 and 1974 through 1976, however, only about 26% of capital gain income was realized by individuals with adjusted gross income over $100,000. Our estimate of the effective tax rate on capital gain income in 1979 assumes a distribution of capital gain close to that which held in 1976 rather than the distribution that held in the 1967 through 1969 period."

In my opinion, it is faulty to assume a distribution of 1979-1980 capital gain income similar to the 1976 experience.

Obviously, the distribution of capital gain income in a given year is essential to a determination of capital gains tax receipts. The larger the percentage of high tax bracket individuals accounting for capital gains realizations, the higher the tax revenues generated by these realizations.

Prior to 1970, tax returns with adjusted gross income (A.G.I.) of $100,000 steadily increased their share of net long-term capital gains. This is a natural development in an inflationary environment -- not an unusual one as assumed by the Treasury. In general, individuals with high incomes account for most risk investing that can result in capital gains. Moreover, the number of such tax returns more than doubled between 1964 and 1969.

The 1969 capital gains tax increase fell primarily on individual investors with high incomes and large long-term capital gains. After 1969, the share of total capital gains accounted for by A.G.I.'s of over $100,000 fell sharply to 1975-1976 low points, in spite of the fact that the number of these tax returns increased 192% from 1970 to 1976. This decline in percentage share of capital gains is powerful evidence that the 1969 capital gains tax increase adversely affected realizations and that the 1978 decrease in rates is likely to have had the opposite effect -- realizations by the upper income groups can be expected to have dramatically increased in 1979 and 1980. Thus, the Treasury Department has based revenue estimates on a distribution of capital gain income that was probably altered greatly by the 1978 Tax Act.

TABLE II

	Share of Net Long-Term Capital Gains Accounted for by Taxable Returns with A.G.I.'s over $100,000*	Number of Taxable Returns with A.G.I.'s over $100,000
1964	29.5%	36,146
1965	31.8	45,728
1966	31.4	52,799
1967	34.1	66,622
1968	36.9	81,685
1969	38.6	81,366
1970	31.0	77,290
1971	31.7	90,720
1972	32.7	114,211
1973	29.2	135,021
1974	28.1	165,470
1975	25.8	184,410
1976	25.9	225,781

---

* Net long-term capital gains after carry-over of long-term capital losses from sale of capital assets.

A.G.I. = Adjusted Gross Income

Source: U.S. Department of the Treasury, Internal Revenue Service, Statistics of Income - Individual.

Taxpayers at the higher income levels received significant capital gains tax relief (the maximum rate on long-term capital gains was lowered from just under 50% to 28%), and such relief was probably reflected in a much higher share of realizations in 1978 and subsequent years. The Belridge Oil situation is one prime example. Such a shift in the distribution of capital gains would offset, to some degree, any decline in the effective tax rate from the 1978 level.

Furthermore, since 1969, virtually all taxpayers -- but particularly those in the upper income groups -- have been pushed into higher tax brackets by inflation and the growth of two-income families. Because of this "bracket creep," the taxable portion of a long-term capital gain becomes taxed at steadily higher rates. Thus, inflation together with the progressivity of the tax structure provides for built-in increases in capital gains taxes.

Bracket creep -- especially in 1978-1980 -- should offset part of the impact of the capital gains tax reduction on the effective tax rate for capital gain income. There is no indication of any allowance for this factor in the Treasury's comparisons of 1979-1980 effective tax rates with those in 1967-1969 or with that in 1978. On the other hand, the Treasury Department does adjust the 1978 effective tax for the tax reductions of that year.

For the foregoing reasons, we believe that higher realizations of long-term capital gains may offset a much larger part of any revenue loss due to the 1978 changes than the Treasury estimates. This would suggest that most of the initial revenue loss due to lower rates was offset by higher realizations induced by the tax changes.

Conclusion

Experience with the 1978 capital gains tax reduction indicates that there are further steps that could be taken to encourage individual investing. Furthermore, the costs of such measures are low, when the feedback effect from higher realizations of capital gains are considered.

(1) The part of a long-term capital gain excluded from Federal income taxes could be raised from 60% to 70%.

(2) The holding period needed to qualify for long-term capital gains tax treatment could be brought back "to more than six months" from "more than one year."

(3) The special tax penalty on investment income and gains imposed by Federal income tax rates of over 50% to 70% could be eliminated, if necessary, in steps. The maximum rate on all forms of income would then be 50%. This reduction would also lower tax rates on long-term and short-term capital gains, accelerating realizations and adding offsetting tax receipts.

Based on results of the 1978 capital gains tax changes, one can be confident that such steps would have positive effects on our equity markets and on the ability of many companies to obtain capital, grow, and add jobs.

Oscar S. Pollock
Ingalls & Snyder

Author's Note:

A more comprehensive text may be obtained by calling Ms. Shirley Safron of Ingalls & Snyder at (212) 269-7817.

SECURITIES INDUSTRY STATISTICS

VOLUME

	MAY 1980	YEAR-TO-DATE 1980	MAY 1979	YEAR-TO-DATE 1979	% CHG. Y-T-D 1980 - 1979
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	36.4	42.1	28.3	28.5	47.7%
AMEX (MILS.)*	3.8	5.8	3.9	3.7	56.8
NASDAQ (MILS.)*	15.8	20.8	13.1	12.4	67.7
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	23,425	140,633	18,019	86,678	62.2
AMEX (MILS.)	1,579	12,158	1,421	6,410	89.7
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	4,832	29,503	4,903	23,433	25.9
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	8,906	53,464	10,105	48,481	10.3
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	31.4	30.2	26.6	26.1	15.7
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	2,996	19,029	2,266	12,673	50.2
AMEX OPTIONS	1,748	10,768	1,235	5,999	79.5
COMMODITY	6,127	31,792	6,634	29,579	7.5

* *MONTHLY AVERAGE*

YIELDS

(MONTHLY AVERAGES)

	JUNE 1980	JUNE 1979	BASIS POINT CHANGE
BOND BUYER INDEX (20 BOND)	7.63	6.12	151
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	10.58	9.29	129
Baa CORPORATE	12.71	10.38	233
RATIO Aaa CORPS. TO Baa CORPS.	.83	.89	----
MUNICIPAL BOND YIELDS (MOODY'S)	7.11	5.54	157

PRICES

(END OF MONTH)

	JUNE 1980	JUNE 1979	PERCENTAGE CHANGE
DOW JONES INDUSTRIALS	867.92	841.98	3.1%
STANDARD & POOR'S 500	114.24	102.91	11.0
NYSE COMPOSITE	65.34	58.38	11.9
AMEX MARKET VALUE INDEX	293.61	200.76	46.2
VALUE LINE COMPOSITE	123.71	114.02	8.5
NASDAQ COMPOSITE	157.78	138.13	14.2

UNDERWRITING
(DOLLARS IN MILLIONS)

	APRIL 1980	YEAR-TO-DATE 1980	APRIL 1979	YEAR-TO-DATE 1979	% CHANGE April- 1980 April- 1979	% CHANGE Y - T- D
CORPORATE FINANCING (Gross New Issues)						
Total	4,050	13,780	3,493	10,656	15.9	29.3%
Competitive	430	1,764	890	2,342	(51.7)	(24.7)
Negotiated	3,619	12,016	2,603	8,314	39.0	44.5
Common Stock	758	3,383	318	1,620	138.4	108.8
# Of Common Stock Issues	34	125	24	86	41.7	45.3
Preferred Stock	160	748	103	447	55.3	67.3
# Of Preferred Stock Issues	4	20	4	13	0	53.8
Corporate Debt	3,131	9,649	3,073	8,589	1.9	12.3
# Of Corporate Debt Issues	34	111	34	90	0	23.3
MUNICIPAL FINANCING* (Gross New Issues)						
Total	8,869	21,799	7,532	21,749	17.8	0.2
Notes	4,365	9,663	4,406	8,901	(1.0)	8.6
Bonds	4,504	12,136	3,126	12,848	44.1	(5.5)
# of Bond Issues	343	1,171	401	1,366	(14.5)	(14.3)
Negotiated Bonds	2,851	7,019	1,649	6,179	72.9	13.6
Revenue Bonds	2,863	7,417	1,999	8,346	43.2	(11.1)

*Preliminary Figures

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	MAY 1980	YEAR-TO-DATE 1980	MAY 1979	YEAR-TO-DATE 1979
NET SALES*	170.5	(94.1)	(278.7)	(947.8)
NET PURCHASE OF COMMON STOCK*	(324.2)	(1,427.3)	(380.0)	(1,478.9)
NET PURCHASE OF OTHER SECURITIES*	543.3	819.5	143.7	449.8
MUTUAL FUND CASH POSITION	11.6	---------	10.0	----------

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	MAY 1980	MAY 1979	PERCENTAGE CHANGE
MARGIN DEBT OUTSTANDING ($MILS)	11,270	11,130	1.3%
NET CHANGE IN MARGIN DEBT ($MILS)	130	(90)	-----
% OF ACCOUNTS WITH EQUITY UNDER 40%	13	13	-----

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	FIRST QUARTER 1980	FIRST QUARTER 1979	ABSOLUTE CHANGE 1st Quarter 1980 - 1979	PERCENTAGE CHANGE 1st Quarter 1980 - 1979
REVENUE				
SECURITIES COMMISSION INCOME	1,486	858	628	73.2%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	543	624	(81)	(13.0)
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	202	174	28	16.1
TOTAL REVENUE	3,490	2,431	1,059	43.6
TOTAL EXPENSES	3,219	2,197	1,022	46.5
NET INCOME BEFORE TAXES	271	234	37	15.8%
PERCENT OF FIRMS SHOWING LOSS	20	19		

SOURCE: FOCUS REPORT X-17A-20

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Germany Faces a Troubled Decade	Four-page report outlining the capital, payments, inflation, personnel, and technological problems confronting West Germany. Includes an interview with Germany's Finance Minister.	Institutional Investor June 1980 p. 169
The New York Futures Exchange Grapples with its Future Institutional Investor	Article detailing strategy of the New York Stock Exchange in its attempt to capitalize on the stunning growth of financial futures.	Institutional Investor June 1980 p. 183
A Better Way to Boost Capital Spending	Interview in which two economists, Jorgenson and Auerbach, explain their proposed alternative to the Capital Cost Recovery Act. The full depreciation allowance would be given the same year as an asset was bought, thus eliminating the effect of inflation.	Fortune June 16, 1980 p. 211
Securities Law and Regulation	Four-page article describing the April 4th initial proposal, by the Securities Exchange Commission, for additional regulation of investment advisors. Provides historical perspective, raises some interesting questions.	Financial Analysts Journal May-June 1980 p. 12
The New Financial Environment	A 47-page report on recent developments in the securities industry, their impact, and the implications for the new decade. Illustrated.	First Boston April 1980
The Securities Industry Under Negotiated Brokerage Commissions	Paper examining the effects of competitive brokerage commission rates on the structure and performance of the NYSE brokerage industry. Authors, relying heavily on SEC statistics, conclude that no negative public-policy effects were incurred by the abolition of fixed commission rates. Seven tables.	Bell Journal of Economics Spring 1980 p. 29

ITEM	DESCRIPTION	SOURCE
The Depository Institutions Deregulation and Monetary Control Act of 1980	Ten-page article detailing Public Law 96-221, approved by President Carter on March 31,1980. The legislation resolves many of the problems pertaining to the structure of financial institutions. Senator Proxmire refers to it as the most significant banking legislation since the Federal Reserve Act of 1913.	Federal Reserve Bulletin June 1980 p. 444
World Economic Outlook	Detailed survey (119 pages) of the economic situations of the oil exporting, industrial, and non-oil developing countries. Focusing on recent developments, the report examines the international adjustment process and touches on key policy issues. Lengthy appendices include over 40 tables.	International Monetary Fund May 1980
What Made the Fed Switch Signals? Or Did It?	Brief article reporting that while interest rates have dropped, Federal Reserve Board Governor Emmett Rice and Fed Chairman Paul Volcker maintain that the Fed policy has not changed.	Forbes June 9, 1980 p. 151
Harold Wilson's City, The Wilson Report	Two articles on the massive report prepared by Sir Harold Wilson's committee on financial institutions. "The Wilson Report" is a two-page summary. "Harold Wilson's City" analyzes the report, the problems with Britain's capitail markets it is reacting to, and the possible constructive Tory response.	The Economist June 28-July 4, 1980 pp. 14 & 90

JUDITH S. WILLINGHAM

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Securities Industry Trends

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

A8825-1

Volume VI Number 7

August 25, 1980

MIDDLE MANAGEMENT COMPENSATION IN THE SECURITIES INDUSTRY

HIGHLIGHTS

1. This issue of Trends reports some of the findings of a 112 page SIA study on 1979 middle management compensation practices in the securities industry.

2. In 1979, the increase in base salaries for department heads averaged about 12%. Heads of some departments commanded considerably higher salaries than those of other departments. Those in charge of systems received almost double what those responsible for payroll and wire services did. Furthermore, the highest salaried positions tended to average the highest bonuses -- both in terms of absolute dollars and as a percentage of total cash compensation.

3. Within the operational area, Group Section Managers received about 30% more than Supervisors and 30% less than Department Managers. At all three levels, those holding managerial positions within "credit/margin" departments were compensated the highest, those within "transfer" departments, among the lowest.

4. Positions within the "human resources" area received a considerably higher salary in 1979 compared to 1978. For the most part, however, salaries still lagged behind those of comparable positions within other areas.

5. For the specialized position categories of "compliance examiner," "auditor," and "programmer," there was a 27-31% increase in median base salaries from the junior to intermediate levels and from the intermediate to senior levels.

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Introduction

Recently, SIA completed its annual Report on Management and Professional Earnings in the Securities Industry. The 112 page study was based on a survey of 26 securities firms located in New York City and includes information on salary and total cash compensation (combined salary and bonus) for 74 job categories during 1979.1/ For a list of the firms participating in the survey and the job categories covered, see Appendices A and B.

Special emphasis was placed on the operational area where three categories of managerial responsibility were covered -- supervisors, section heads and department heads. The survey also covered department heads responsible for 11 different non-operational functions within securities firms. Recognizing the increasing diversification and complexity of securities firms, there were 18 job positions covered under the "specialized positions" category and 11 positions falling under the general umbrella of "human resources management." Other broad categories included "administration & finance" and "floor department."

Department Heads

The average department head received a base salary of $31,800 last year as compared to $28,500 in 1978, or an increase of 11.6%. Ten of the 11 department head categories received an increase in base salary over 1978. We attribute the decrease in one category to personnel turnover with less experienced individuals replacing those with greater seniority and, to a lesser degree, changes in the participating firms.

Within the 11 department head categories, there was a wide divergence in the median annual base salary paid.2/ Department heads in charge of systems received almost double what those responsible for payroll and wire services did. In terms of mean base salary, department heads in charge of internal auditing were next to system heads in level of compensation.

1/ Additional copies are available for $20 for firms who participated in the survey (see Appendix A). For SIA members not participating in the survey, a copy is available at $275. Non-members may obtain copies at $400. To order copies, write Ms. Judith S. Willingham, SIA, 20 Broad Street, New York, NY 10005. Checks must accompany all orders.

2/ The median is the figure which lies at the midpoint of an array. In contrast, the mean is computed by dividing the total value by the number of observations.

Internal auditing department heads had considerable skewness in their base salaries, as their mean base salary exceeded the median by 23%. In none of the other 10 department head categories was such an uneven distribution of compensation apparent.

Table 1

Variance in Base Salaries

Department Head	Variance*
Wire	6%
Communications	1
Order	9
Office Services	6
Auditing (Internal)	18
Assistant Cashier (Stock or Money)	0
Payroll & Commissions Manager	1
Programming	4
Systems	1
Computer Operations	1
New Accounts	(3)

* Mean - median ÷ mean.

The department head categories with the highest salaries also generally received the highest bonuses -- both in terms of absolute dollars and as a percentage of total cash compensation. For example, bonuses raised the median compensation for systems department heads by about 35% but for those responsible for new accounts by only 3%. On average, bonuses increased the total cash compensation of all department head categories by roughly 20%. Bonuses increased total cash compensation by at least 10% for every department head category other than "new accounts."

Table 2

Relative Importance of Bonuses

Department Head	Base Salary + Bonus ÷ Base Salary
Wire	14%
Communications	10
Order	22
Office Services	27
Auditing (Internal)	27
Assistant Cashier (Stock or Money)	28
Payroll & Commissions Manager	16
Programming	20
Systems	34
Computer Operations	19
New Accounts	3

Operations

The three managerial levels, in order of increasing responsibility, were: Supervisor, Group Section, and Department. As expected, compensation rose with the level of responsibility. Group Section Managers received, on the average, about 30% more than Supervisors and 30% less than Department Managers.

Apparently, department managers of operations functions were in considerable demand last year. The average increase in mean base salary exceeded 13%. In particular, department managers responsible for receiving and delivering securities had a median base salary almost 25% higher than in 1978 while salaries paid to section managers in the same department were up only 8.5%.

At all three levels within the operational area, those holding managerial positions within credit/margin departments were compensated the highest, those within transfer departments, among the lowest. These differences were most pronounced at the highest levels of responsibility. The median base salary and total cash compensation were about 33% and 40% higher, respectively, for credit/margin department managers than for transfer department managers.

As reflected in differences between the mean and median base salaries, there was relatively modest variance in base salaries within job categories in the operations departments. Generally, the variance in total cash compensation increased at the higher level positions. For example, there was an average difference of 42% between the 25th and 75th percentiles for department heads within the operations area as compared to a difference of 26% for supervisors.

Human Resources

As securities firms are becoming larger with greater numbers of employees, managerial positions in the human resources area are attaining greater importance and, in turn, higher compensation. As compared to Controllers and Compliance Directors, Personnel Directors enjoyed a larger increase in base salary last year over 1978. When bonuses are included, personnel directors still do considerably better than compliance directors, though not quite as well as controllers. Still, despite these increases, personnel directors continue to make much less than directors outside the human resources area. Furthermore, compensation gains appear to have been unevenly distributed among personnel directors. There was considerable variance in total cash compensation received by personnel directors in 1979. For example, the range between the 25th and 75th percentiles was $35,500.

Within various managerial categories in the human resources area, those responsible for developing personnel in operations or data processing did exceptionally well in 1979, both in terms of 1978-1979 increases and compensation rate. Only sales training managers were compensated anywhere near those involved in operations or data processing.

Specialized Positions

As expected, those positions with more seniority and responsibility were compensated at higher levels. For example, the median base salary for an intermediate compliance examiner exceeded that for a junior compliance officer by 27%. In turn, senior compliance officers received compensation 31% greater than that of intermediate examiners. The same pattern existed for the "auditor" and "programmer" categories.

Of all the specialized positions, the greatest variance, as measured by the difference between the 25th and 75th percentile, was in the median total cash compensation received by senior stock loan managers. Those in the 75th percentile received almost double those in the 25th percentile. Table 3 below shows the variance in the middle 50% range for the 18 specialized positions included in the survey.

Table 3

Variance in Compensation Paid to Specialized Positions

Specialized Positions	Variance*
Junior Compliance Examiner	3%
Intermediate Compliance Examiner	18
Senior Compliance Examiner	20
Junior Internal Auditor	25
Intermediate Internal Auditor	16
Senior Internal Auditor	30
Trainee Programmer	16
Intermediate Programmer	16
Senior Programmer	23
Programmer Analyst	31
Senior Programmer Analyst	23
Systems Analyst	35
Senior Systems Analyst	31
Librarian	42
Editor	6
Junior Stock Loan Manager	17
Intermediate Stock Loan Manager	23
Senior Stock Loan Manager	48

* 75th percentile - 25th percentile ÷ 75th percentile.

Judith S. Willingham
Research Assistant

Jeffrey M. Schaefer
Vice President and
Director of Research

Appendix A

LIST OF PARTICIPATING FIRMS

Bache Halsey Stuart Shields, Inc.
Bear Stearns & Co.
Brown Brown Harriman & Co.
Cowen & Co.
Dean Witter Reynolds, Inc.
Donaldson Lufkin & Jenrette, Inc.
Drexel Burnham Lambert, Inc.
Europartners Securities Corp.
First Boston Corp.
Goldman Sachs & Co.
Herold (Bernard) & Co.
Hutton (E.F.) & Co.
Lazard Freres & Co.
Marcus Schloss & Co., Inc.
Morgan Stanley & Co., Inc.
Oppenheimer & Co., Inc.
Paine Webber Blyth Eastman, Inc.
Richardson Securities, Inc.
Rothschild (L.F.) Unterberg Towbin,
Salomon Brothers
Shearson Loeb Rhoades, Inc.
Thomson McKinnon Securities, Inc.
Viner (Edward A.) & Co.
Wagner Stott & Co.

Appendix B

JOB CATEGORIES

Department Heads
Wire
Communications
Order
Office Services
Auditing (Internal)
Assistant Cashier (Stock or Money)
Payroll & Commissions Manager
Programming
Systems
Computer Operations
New Accounts

Operations Managers (Department Managers)
Credit (Margin)
P & S
Dividends
Transfer
Stock Record Department
Receive & Deliver
Box

Operations Managers (Group Section Managers)
Credit (Margin)
P & S
Dividends
Transfer
Stock Record Department
Receive & Deliver
Box

Operations Managers (Supervisors)
Credit (Margin)
P & S
Dividends
Transfer
Stock Record Department
Receive & Deliver
Box

Other Supervisory Jobs
Keypunch Supervisor
NYSE/AMEX Floor Supervisor

Specialized Jobs
Junior Compliance Examiner
Intermediate Compliance Examiner
Senior Compliance Examiner
Junior Internal Auditor
Intermediate Internal Auditor
Senior Internal Auditor
Trainee Programmer
Intermediate Programmer
Senior Programmer
Programmer Analyst
Senior Programmer Analyst
Systems Analyst
Senior Systems Analyst
Librarian
Editor
Junior Stock Loan Manager
Intermediate Stock Loan Manager
Senior Stock Loan Manager

Human Resources and Operations Management
Compensation Manager
Benefits Manager
Employment Manager
Sales Training Manager
Operations Training Manager
Operations Manager
Data Processing Manager
Compensation Analyst
Benefits Analyst
Employment Interviewer
Sales Recruiter

Miscellaneous Jobs
Buyer
Printing Supervisor

Administration & Finance
Controller
Director, Personnel
Director, Compliance

Floor Department Positions
Director, Floor Department
Floor Brokers (NYSE)
Floor Brokers (AMEX)
Floor Brokers (Regional)

Operations
Director of Operations & Data Processing

Research
Chief Technical Analyst

SECURITIES INDUSTRY STATISTICS

	VOLUME				
	July 1980	YEAR-TO-DATE	July 1979	YEAR-TO-DATE	% CHG. Y-T-D 1980 - 1979
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	46.4	42.4	32.4	29.9	41.8%
AMEX (MILS.)*	6.2	5.8	3.9	3.9	48.7
NASDAQ (MILS.)*	23.8	20.9	15.2	13.3	57.1
REGIONAL EXCHANGE (MILS.)*	----				
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	32,606	199,593	19,637	126,833	57.4
AMEX (MILS.)	3,380	17,849	1,397	9,656	84.8
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	5,894	40,389	4,728	33,349	21.1
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	12,592	76,594	10,369	69,592	10.1
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	28.7	29.9	28.4	26.5	12.8
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	4,780	30,270	2,777	18,309	65.3
AMEX OPTIONS	2,505	15,319	1,306	8,657	77.0
COMMODITY	9,065	47,535	7,166	44,488	6.8

* *MONTHLY AVERAGE*

YIELDS

(MONTHLY AVERAGES)

	June 1980	June 1979	Basis Point Change 1980 - 1979
BOND BUYER INDEX (20 BOND)	7.63	6.12	151
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RATIO Aaa CORPS. TO Baa CORPS.	.83	.89	---
MUNICIPAL BOND YIELDS (MOODY'S)	7.11	5.54	157

PRICES

(END OF MONTH)

	July 1980	July 1979	Percentage Change
DOW JONES INDUSTRIALS	935.32	846.42	10.5%
STANDARD & POOR'S 500	121.67	103.81	17.2
NYSE COMPOSITE	69.64	59.14	17.8
AMEX MARKET VALUE INDEX	314.49	198.69	58.3
VALUE LINE COMPOSITE	134.50	115.79	16.2
NASDAQ COMPOSITE	171.81	141.33	21.6

UNDERWRITING
(DOLLARS IN MILLIONS)

	June 1980	Year-to-Date 1980	June 1979	Year-to-Date 1979	% Change June 1980 June 1979	% Change Y- T- D
CORPORATE FINANCING (Gross New Issues)						
Total	8531	30058	4449	18501	91.8%	62.5%
Competitive	702	2600	436	3311	61.0	(21.5)
Negotiated	7828	27458	4018	15206	94.8	80.6
Common Stock	863	5122	333	2211	159.2	131.7
# Of Common Stock Issues	62	227	25	135	148.0	68.1
Preferred Stock	370	1309	115	649	221.7	101.7
# Of Preferred Stock Issues	9	35	3	20	200.0	75.0
Corporate Debt	7299	23627	4007	15658	82.2	50.9
# Of Corporate Debt Issues	77	262	45	164	71.1	59.8
MUNICIPAL FINANCING* (Gross New Issues)						
Total						
Notes	8101	36971	6143	116877	31.9%	(68.4)%
Bonds	2098	13775	1660	96629	26.4	(85.7)
# of Bond Issues	6004	23196	4483	20248	33.9	14.6
Negotiated Bonds	427	2294	568	2495	(24.8)	(8.1)
Revenue Bonds	3123	13509	2279	9751	37.0	38.5
	3850	14373	2853	12971	34.9	10.8

*Preliminary Figures

MUTUAL FUNDS
(DOLLARS IN MILLIONS)

	June 1980	Year-to-Date 1980	June 1979	Year-to-Date 1979
NET SALES*	167.3	73.2	(129.9)	(1077.7)
NET PURCHASE OF COMMON STOCK*	(153.2)	(1580.5)	(262.6)	(1741.5)
NET PURCHASE OF OTHER SECURITIES*	611.0	1430.6	147.4	597.2
MUTUAL FUND CASH POSITION	10.7	---	10.1	----

*EXCLUDES MONEY MARKET, MUNICIPAL BOND AND OPTION FUNDS

MARGIN DEBT

	July 1980	July 1979	% Change 1980 - 1979
MARGIN DEBT OUTSTANDING ($MILS)	11320	11840	(4.4)%
NET CHANGE IN MARGIN DEBT ($MILS)	120	250	----
% OF ACCOUNTS WITH EQUITY UNDER 40%	10	11	----

* ALL TIME HIGH

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	FIRST QUARTER 1980	FIRST QUARTER 1979	ABSOLUTE CHANGE 1st Quarter 1980 - 1979	PERCENTAGE CHANGE 1st Quarter 1980 - 1979
REVENUE				
SECURITIES COMMISSION INCOME	1,486	858	628	73.2%
REALIZED AND UNREALIZED GAIN OR LOSS IN TRADING AND INVESTMENT	543	624	(81)	(13.0)
PROFIT OR LOSS FROM UNDERWRITING AND SELLING GROUPS	202	174	28	16.1
TOTAL REVENUE	3,490	2,431	1,059	43.6
TOTAL EXPENSES	3,219	2,197	1,022	46.5
NET INCOME BEFORE TAXES	271	234	37	15.8%
PERCENT OF FIRMS SHOWING LOSS	20	19		

SOURCE: FOCUS REPORT X-17A-20

RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Stock Market Behavior Around Business Cycle Peaks	Combining and averaging the evidence from this century's 13 business cycles (reported by the National Bureau of Economic Research), the author of this study finds stock prices usually lead general business activity. Among his conclusions: the ideal time to sell stocks is one to three months before a recession begins, but selling up to eight months before would be almost as profitable.	Financial Analysts Journal July/August 1980 p.55
Comparison of Individual Taxation of Long and Short Term Capital Gains on Portfolio Stock Investments in Ten Countries	Study prepared by Arthur Anderson & Co., overviewing the taxation gains realized on the sale of portfolio stock investments by individual residents of ten countries. Includes a summary of changes in taxation over the past five years.	Securities Industry Association July 30, 1980
SDR Substitution, the Dollar, or Multiple Reserve Assets: Where Are We Bound from Here?	Fifteen-page study concluding that even if the obstacles hindering the institution of the SDR substitution account are overcome, some incentives for reserve asset diversification will remain. The SDR's proportional share in official reserves can be influenced greatly by its inherent characteristics. Five charts.	Voice of the Federal Reserve Bank of Dallas July 1980 p.5
Is Beta Dead?	Lengthy article on a new debate as to the validity of "modern portfolio theory." The debate's conclusion could have a profound impact on the way money is managed.	Institutional Investor July 1980 p.22
America the Sluggish	Two-page article discussing the dangerous slowdown in U.S. productivity growth. Author reviews the four primary factors: growing proportion of young and inexperienced workers, inadequate investment, new government regulations, and "x factor."	The Economist July 26-August 1 p.14

ITEM	DESCRIPTION	SOURCE
Restrictive Policies Hold Back Recovery	Economic forecast focusing on the industrial nations. Based on "Project Link," an econometric model of the global economy. Ten pages, twenty-five graphs (real GNP, real GDP, consumer prices, balance of payments, unemployment, trade volume).	Business Week August 4, 1980 p.36
Why U.S. Industry Needs Help	Author Amitai Etzioni argues that a large tax cut and firm control of government expenditures won't be enough to restore economic health. Government policy will have to actively encourage investment at the expense of public and private consumption.	Forbes August 18, 1980 p.120
Reagan's Economic Guru	Arthur Laffer, devisor of the Laffer Curve and economic mentor to Ronald Reagan, interviewed here on his theory that a return to a program of convertibility into gold is necessary to halt the dollar's erosion.	Euromoney August 1980 p.31
Ranking America's Top Money Managers	A ranking of the 300 largest money management organizations as of year-end 1979. Lists total assets, portfolio mix, and pension & employee benefit assets. Total assets are now over $1 trillion. Also ranks 100 institutions with the largest dollar volume of equities in their portfolios.	Institutional Investor August 1980 p.63

JUDITH S. WILLINGHAM

Introduction

The volatile nature of the securities business produces a distorted reflection of general economic conditions. The industry outperformed an expanding U.S. economy through the 1960s and underperformed a generally sluggish economy through most of the following decade. During the first half of 1980, the U.S. economy continued to suffer from stagflation. In real terms, GNP plunged 9.0% during the second quarter after a moderate increase of 1.2% in the preceding quarter. At the same time, inflation continued at an unacceptable 13% rate during the second quarter, having exceeded an annualized 17% during the first three months. The prime rate started the year at 15%, peaked at 20% and descended to the 12-14% range in June.

This six month period, nonetheless, provided ample profit opportunities for broker/dealers, with the securities industry earning an estimated 26.7% annualized after-tax return on equity (ROE). On a quarterly basis, the ROE is even more interesting. The annualized after-tax ROE for the first quarter was 14.6%, remarkable in view of the 220 basis point rise in Aaa corporate yields which caused the bond market debacle. In the second quarter, it reached a staggering 39.1%. However, the second quarter experience represents a cyclical upswing rather than a return to halcyon days.

This issue of Trends, and another to follow shortly, will analyze the securities industry's performance through this six month period with the same detail found in a "Year in Review" issue. It is a sign of the accelerating rate of change within the securities industry that a "Year in Review" should be warranted after six months. Through the end of June, the securities industry's gross revenues and the six month figure for value of shares traded on the NYSE -- $167 billion -- exceeded that for any full year prior to 1978. Of even greater interest than the net income figure for the two quarters is the way in which those earnings were generated. A thorough analysis of the industry's results over this period will yield valuable insights into the shifting nature of the business.

At the end of June, the industry's equity capital stood at $4,675 million, up from $3,940 million six months earlier, vindicating the hypothesis that capital is readily available, from external as well as internal sources, whenever risk-adjusted returns are attractive. Some industry capital might be reallocated or withdrawn were profitability to return to the disappointing levels of the 1970s, but, for the moment, criticism of the industry's "failure" to attract sufficient capital should be dismissed.

Revenues

The very different factors at work in the first and second quarters suggest the need for revenue and expense breakdowns on a quarterly basis. The revenue breakdown is given below.

Table 1
Securities Industry Revenues
(millions of dollars)

	1Q 1980	2Q 1980	First Half 1980	As a % of Gross Revenues
Commissions	$1,485	$1,027	$2,512	33.1%
Trading & Investment	543	1,408	1,951	25.7
Margin Interest	560	502	1,062	14.0
Underwriting	202	357	559	7.4
Mutual Fund Sales	16	30	46	0.6
Commodities	147	127	274	3.6
Account Supervision	36	36	72	0.9
Research	5	3	8	0.1
Other Related	375	410	785	10.4
Other Unrelated	121	192	313	4.1
Gross Revenues	$3,490	$4,092	$7,582	100.0%
Net Income Before Taxes	$271	794	1,065	
Estimated After-Tax Net	$146	429	575	

While gross revenues have been on a marked upward trend since 1977, individual revenue sources remain highly cyclical. Some business segments, such as account supervision, display quarter-to-quarter stability and may have the potential to lower earnings volatility. Nevertheless, Table 1 indicates that the securities industry remains subject to pronounced quarterly revenue swings despite much heralded diversification moves.

Commissions

The industry's experience in the first quarter of 1980 was to some extent a repetition of 1978, in that record volume and commission revenues did not produce record profits. With surging NYSE, Amex, and NASDAQ volume, commissions rose to 42.6% of first quarter gross revenues, as compared to 35.6% for all of 1979. At $1,485 million, first quarter commission revenues were very impressive.

The equity markets in this quarter displayed a vitality not seen in years, with signs of renewed retail as well as institutional interest. A recognition of the superior growth potential of smaller companies and expectations concerning energy price decontrol enabled the unweighted market indices to outperform substantially the Dow Jones Industrials. The ability of stock prices to rise in the face of soaring interest rates was an encouraging sign. By the end of the quarter, however, the highly selective -- and, alas, short-lived -- nature of this market rise, with its heavy emphasis on energy and other natural resource companies, suggested less a renewal of faith in corporate earnings growth than simply another manifestation of the flight into tangible assets.

In the second quarter, commission revenues declined to $1,027 million, or 25.1% of gross revenues. This drop in commission income was greater than that in volume, for second quarter volume was high by any standard other than that of the preceding three months. The jump in other revenues explains the decline in commissions more in relative than absolute terms.

Trading and Investment

Due to the rise of the dealer function, the securities business becomes increasingly a matter of determining, or attempting to determine, interest rate fluctuations. These fluctuations -- and not exchange volume -- were the key factors behind the swing in industry profitability during the first two quarters. The actual figures for trading and investment profits -- $543 million in the first quarter, $1,408 million in the second -- are overstated, due to a peculiarity of the current reporting system whereby accrued interest and dividends on long positions are included in trading and investment profits*. The second quarter trading and investment figure, even if scaled down for financing charges, is plainly the key to that quarter's exceptional level of earnings. In contrast, the first quarter produced for U.S. investors fixed income portfolio losses conservatively estimated at $100 billion. Weekly closes of the Dow Jones Twenty Bond Average, shown below, give an idea of the hectic fixed income market conditions through the six month period.

Table 2
Dow Jones Twenty Bond Average, First Half 1980

Week Ending	Close	Week Ending	Close	Week Ending	Close
January 4	73.76	March 7	64.24	May 9	72.39
January 11	73.92	March 14	64.39	May 16	72.32
January 18	73.64	March 21	64.82	May 23	72.28
January 25	71.89	March 28	63.87	May 30	72.55
February 1	71.01	April 4	64.19	June 6	73.22
February 8	69.30	April 11	66.64	June 13	74.81
February 15	68.18	April 18	68.87	June 20	76.60
February 22	66.02	April 25	70.70	June 27	75.35
February 29	65.80	May 2	71.71		

Source: Barron's

*In the SEC's proposed changes to FOCUS, interest and dividends would be excluded from trading and investment revenues. This is a reform long overdue.

To function at all smoothly in this environment, the securities industry had to have short as well as long positions. The information below testifies to the industry's increased hedging dexterity and provides insights as well into trading desks' expectations concerning short-term trends in interest rates.

Table 3
Long and Short Positions in
Securities and Commodities
(millions of dollars)

	12/31/77	12/31/78	12/31/79	3/31/80	6/30/80
Long Positions	$13,799	15,238	20,161	16,750	23,027
Short Positions	$ 3,980	6,610	13,705	7,309	9,844
Short as a Percentage of Long	28.8%	43.4%	68.0%	43.6%	42.7%

A comparison of the securities industry's recent performance with that of 1978, especially, provides considerable satisfaction. Abnormal market conditions appear to have become the norm, and securities firm managements and trading desks have displayed great skill in adapting to a more volatile market environment.

Margin Interest

Margin interest revenues are a function of interest rates and of the amount of margin debt outstanding. Though closely linked to the commission business, it is a borrowing/relending activity resembling those of many other financial intermediaries. Developments in the precious metals market in late March focused attention upon the price volatility of the positions collateralizing margin loans. However, of the $17.7 billion in customer receivables on the industry's balance sheet at the end of the first quarter, only $1,161 million, or 6.5%, was in commodities accounts. By the end of the second quarter, commodity-related customer receivables were down to $382 million.

The first quarter, being a period characterized by feverish trading activity and high interest rates, saw margin income at record levels. Below are margin interest revenues for the last six quarters.

Table 4
Securities Industry
Quarterly Margin Interest Revenues

	1979				1980	
	1Q	2Q	3Q	4Q	1Q	2Q
Millions of Dollars	$353	$362	$425	$505	$560	$502
As a % of Gross Revenues	14.8%	13.5%	14.3%	16.0%	16.0%	12.3%

The margin lending business is one in which marginal revenue and marginal cost move closely in tandem, and its growing relative importance to the industry in recent years has been a major factor in narrowing profit margins. As shown in Table 5, the relative stability of margin debt outstanding indicates that the marked quarter-to-quarter swings in margin revenue are due mainly to fluctuating interest rates.

Table 5

Margin Debt Outstanding
(millions of dollars, end of month)

1979				1980	
January	$10,750	July	$11,840	January	$11,820
February	10,790	August	12,060	February	12,460
March	10,870	September	12,000	March	11,740
April	11,220	October	11,310	April	11,140
May	11,130	November	10,920	May	11,270
June	11,590	December	11,450	June	11,200

Source: NYSE

The level of margin debt, though less volatile than margin revenues, does reflect market conditions, such as the market downturn of September-November 1979, the strong upward momentum of the first two months of 1980, and the correction experienced in March and April.

Underwriting

The relative decline in the commission business has been paralleled by that of underwriting. This is not surprising, for the problems of the primary market reflect those of the secondary markets. Underwriting is highly sensitive to financing costs, which explains the 77% growth in underwriting revenues from $202 million in the first quarter to $357 million in the second. In the first quarter, prospective issuers were reluctant to commit themselves to high long-term rates, and investors displayed a preference for short-term, high-yield debt instruments. Within weeks of having been pronounced dead, the bond market astonished observers with its ability to absorb the massive volume of corporate offerings prompted by falling rates. Given below, on a monthly basis, are corporate and municipal underwriting volume for the first six months of this year.

Table 6

Underwriting Volume, First Half 1980
(millions of dollars)

Corporate*

	Jan.	Feb.	March	April	May	June	First Half Total
Bonds	$2,843	1,448	2,219	3,131	6,680	7,299	23,621
Preferred	$ 231	75	282	160	191	370	1,309
Common	$ 688	1,204	748	755	882	856	5,136
Total	$3,763	2,727	3,249	4,046	7,753	8,525	30,065

Municipal*

	Jan.	Feb.	March	April	May	June	First Half Total
General Obligation	$1,167	936	733	1,667	1,549	1,886	7,938
Revenue	$1,883	1,455	1,668	3,208	3,045	4,071	15,330
Total	$3,050	2,391	2,401	4,875	4,594	5,957	23,267

Source: Investment Dealers' Digest; Public Securities Association

*Numbers may not add due to rounding.

The corporate finance data reflect the very different conditions that prevailed in the stock and bond markets in the first quarter. February saw the lowest volume in bond and preferred offerings but the highest in common stock offerings. Utility common stock offerings, interestingly, amounted to only 40% of the half year's equity total, after averaging 64% of total equity offerings during 1974-1979. Competitively sold offerings were down to 8.6% of total corporate underwritings for the first half year, from a 1974-1979 average of 19%. Clearly, issuers and underwriters determined that the volatile markets of early 1980 required the flexibility which a negotiated offering provides.

Account Supervision

Account supervision and investment advisory fees, like hard dollar research revenues, remain relatively small as revenue sources and have been very stable over the last few quarters.

Table 7

Account Supervision/Investment Advisory Fees

	1979				1980	
	1Q	2Q	3Q	4Q	1Q	2Q
Millions of dollars	23	29	35	34	36	36
As a percentage of gross revenues	0.9	1.1	1.2	1.1	1.0	0.9

Two aspects of the securities industry's growing presence in the investment advisory field have attracted considerable attention of late -- head-on competition with the industry's institutional customers for portfolio management business and the spectacular rise of money market funds to their current level of $77.3 billion in assets. Securities firms, it is estimated, manage roughly 60-70% of money market fund assets.

As regards competition with the industry's own customers, it is a sign of the times and of the profitability of institutional brokerage. Section 11(a) of the 1975 Amendments reduced the profitability for broker/dealers of managing institutional money. Individual portfolio management is subject to fewer restrictions and is becoming an integral part of the full line financial service concept increasingly embraced by many firms. The potential for competition with commercial bank trust departments is great.

Money market funds are a phenomenon of interest rate ceilings and an inverted yield curve. They sparked a heated attack by commercial banks, and this criticism led to the Federal Reserve's imposition of reserve requirements on incremental fund sales in late March. Table 8, showing the funds' end-of-quarter assets, gives some idea of the stakes involved for the different financial intermediaries.

Table 8

Money Market Fund Assets
(billions of dollars, end of quarter)

4Q 1978	1Q 1979	2Q 1979	3Q 1979	4Q 1979	1Q 1980	2Q 1980
$10.9	18.0	25.9	34.2	45.2	60.5	76.2

Source: Investment Company Institute

As noted above, these funds were produced by a combination of inverted yield curve and interest rate ceilings. A shift in the relative attractiveness of short- and long-term yields, or a modification of interest rate ceilings, or both, could deflate this balloon very quickly, as demonstrated by the current flight of institutional investors out of these instruments. For the securities industry, money market funds are important both as a source of management fees and as a pool of funds that could be redirected into other investment vehicles under appropriate circumstances.

Expenses

Industry expenses are much less volatile than revenues, which goes a long way toward explaining the industry's roller-coaster ride through the 1970s. There exists disagreement as to whether the industry's costs are fixed or variable. The two components of industry expenses are quite readily identifiable. Given below are industry expenses for the first half of the year.

Table 9

Securities Industry Expenses
(millions of dollars)

	1Q 1980	2Q 1980	First Half 1980	As a % of Gross Revenues
Floor Brokerage & Clearance	$ 195	$ 151	$ 346	4.6%
RR Compensation	691	654	1,345	17.7
Clerical & Admin. Salaries	547	632	1,179	15.5
Communications	194	203	397	5.2
Occupancy & Equipment	117	131	248	3.3
Promotional Costs	71	82	153	2.0
Error Accounts & Bad Debts	60	35	95	1.3
Interest Expense	873	895	1,768	23.3
Partners' & Voting Stock-holders' Compensation	130	134	264	3.5
All Other	341	381	722	9.5
Total Expenses	$3,219	$3,298	$6,517	85.9%

Measuring the percentage increase in each expense item between the first half of 1979 and that of 1980 provides insights into whether an expense is fixed or variable. (It does no good to reflect that, in the long term, all costs are variable, for the rate of change within the securities industry is just too rapid.) The relevant question is how a cost increase compares with increases in gross revenues.

Table 10

Percentage Increases in Expenses, 1979-1980

	First Half-First Half
Floor Brokerage & Clearance	9%
RR Compensation	60
Clerical & Admin. Salaries	33
Communications	22
Occupancy & Equipment	21
Promotional Costs	31
Error Accounts & Bad Debts	164
Interest Expense	62
Partners' & Voting Stock-holders' Compensation	28
All Other	23
Total Expenses	41
Gross Revenues	48
Consumer Price Index (June to June)	14.3%

Both revenues and expenses are swollen by interest, but interest cannot be netted out of revenues satisfactorily. In absolute terms, it is the largest expense, accounting for 55% of the expense increase between the two periods. In terms of percentage increase, it was the second highest, surpassed, disconcertingly, by Error Accounts & Bad Debts, a variable cost that seems to rise geometrically in times of swiftly rising volume. Interest expense is a variable cost, but fluctuating interest rates give it a somewhat uncontrollable quality. RR Compensation is determined not just by commission revenues but by complicated formulas involving the investment vehicle, size of the order, and total activity with the customer. Floor Brokerage & Clearance increased at a modest rate, despite its close relationship to volume. This probably relates to the type of firm which generated the greatest increases in volume.

The June to June 14.3% rise in the CPI establishes some yardstick against which to measure increases in the fixed cost categories. Three expense items -- Clerical & Administrative Salaries, Communications, and Occupancy & Equipment -- comprise the backbone of industry overhead. Their rates of increase are more nearly in line with that of the general price level than was true of the variable costs. The relatively steeper climb in Clerical & Administrative may represent a lagged effort to increase capacity or the overtime expense incurred in clearing up erors resulting from the first quarter's high volume.

Volume and Capacity

Planning for the optimal level of capacity remains a key industry concern. Since 1974, the industry has stressed increasing the sales force relative to support personnel. Between year end 1974 and 1979, total employees of NYSE firms increased 26.5%, while sales personnel increased 36.8%. Some of the difference in these figures is due to automation, but a sales-oriented effort to minimize overhead has also been a factor. Many securities industry observers believe that present levels of trading volume are unsustainable while others consider them merely a harbinger of 150 million share days. The table below gives a sense of volume increases on the NYSE during the past decade.

Table 11

NYSE Average Daily Share Volume
(millions of shares)

1970	11.6	1976	21.2
1971	15.4	1977	20.9
1972	16.5	1978	28.6
1973	16.1	1979	32.2
1974	13.9	6 mos. 1980	41.7
1975	18.6		

1980 Average Daily Share Volume
(millions of shares)

January	52.7	April	32.1
February	47.8	May	36.4
March	41.7	June	39.5

Source: NYSE

Closely correlated with volume, of course, is turnover, which is given below. The 1980 figures are annualized over the first six months.

Table 12

NYSE Turnover Ratio, 1970-1980

1970	19%	1976	23%
1971	23	1977	21
1972	23	1978	27
1973	20	1979	28
1974	16	6 mos. 1980	35%
1975	21%		

Monthly Turnover 1980
(Annualized)

January	44%	April	27%
February	40	May	30
March	35	June	32

Source: NYSE

The combined forces of institutionalization and inflation are responsible for most of this volume increase. Between 1968 and 1979, the average number of shares per NYSE trade increased from 302 to 787, while the number of tape prints increased only from 9.7 million to 10.4 million. Inflation has had the paradoxical effect of lowering stock prices, due to a combination of high interest rates and the deteriorating quality of reported earnings-per-share, thus causing many investors to increase the number of shares per order.

As institutions have become more important to the equity markets, equities have become less important to institutions. The data given below on private non-insured pension funds, the fastest growing category of institutional investor, suggest a potential for even greater institutional participation in the equity markets.

Table 13

Private Non-Insured Pension Funds
Summary Data
(dollars in billions)

	1972	1973	1974	1975	1976	1977	1978	1979
Total Assets (book value, year end)	$118	$127	$134	$145	$160	$182	$202	$223
Common Stock as a % of Total Assets	63	64	59	58	58	53	50	50
Activity Rate (%)*	19.7	17.2	14.1	18.2	16.4	17.3	21.0	21.1

*Defined as the average of gross purchases and sales divided by the average market value of stockholdings.

Source: SEC

The above suggests that current volume levels may be, in fact, sustainable, and a rekindling of retail interest could swell the number of transactions. In addition, the agency business in listed equities is just one of many products and services offered by the industry. The commodity, option, and OTC markets, volume on all of which is closely correlated with stock exchange volume, create new profit opportunities along with capacity demands. Early this year, the financial press reported that some firms had established prohibitively high commission charges on small transactions in OTC stocks in an effort to ease the processing snarls wrought by weeks of high volume. In the fixed income markets, too, particularly the municipal market, clearance and settlement procedures are not what they should be.

Questions of volume and capacity lead to a discussion of error account charges, which, as shown below, soared in early 1980.

Table 14

Losses in Error Accounts and Bad Debts, 1979-1980

	1979				1980	
	1Q	2Q	3Q	4Q	1Q	2Q
Millions of dollars	15	21	27	34	60	35
As a % of Gross Revenues	0.6	0.8	0.9	1.1	1.7	0.9

The above indicates that errors, clearly a volume-related expense, increase steeply after a sharp, sustained rise in trading volume. The error charge figures illustrate very effectively the over-/underutilization tradeoffs managers face in this industry. Although further automation promises a way out of this operational impasse, it will, at the same time, raise fixed costs.

Conclusion

The industry's showing in the first half of 1980 boosted both its capital and morale. If the securities industry were simply to break even for the second half of the year, its full year ROE would be respectable in the context of the last three or four years. In the midst of such plenty, there linger, nonetheless, several key matters of concern. A cyclical upswing should not change this industry's cautious stance and planning emphasis.

The highly cyclical nature of the second quarter performance cannot be overstressed. For interest rates to fall abruptly, they must first have risen. The first quarter bond market, then, was a necessary precondition of the second quarter bond market. The business of anticipating interest rate movements is one in which the rewards are commensurate with the risks. In light of the second quarter results, it would be more appropriate to say that the risks are commensurate with the rewards.

As firms continue to seek a balance between inadequate and excess capacity, many in the agency business express doubts as to whether current levels of volume are sustainable. The increasingly fixed cost nature of the business lends a new urgency to this problem. Those who believe volume will go higher are even more concerned, due to the operational strain experienced in the first quarter when volume was high. The consequences of having a transaction flow that exceeds a firm's operational capacity are well known. Eleven or twelve years ago, many firms were literally dying of prosperity.

It would be possible to create a catalogue of potential threats, notable among them those deriving from regulatory uncertainties, but it is more instructive to focus upon macroeconomic conditions which, in the final analysis, determine capital market conditions and the securities industry's profitability.

The U.S. economy is in no sense out of the wilderness. The inflation that has eroded real profitability has also distorted traditional patterns of saving and investment, and interest rate swings are simply responses to inflationary pressures. The securities industry remains vulnerable to external shocks, domestic and foreign, and management must ever anticipate certain eventualities. Through the first half of 1980, the industry showed itself, by and large, capable of understanding and responding to the succession of macroeconomic shocks that jolted the capital markets.

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RECENT INTERESTING READING AND STATISTICAL MATERIAL

ITEM	DESCRIPTION	SOURCE
Securities Industry Yearbook 1980	A comprehensive 387-page book containing detailed information on securities industry firms and the capital markets.	SIA Research Department ($30 for SIA members; $60 for non-members)
"Perspectives on Personal Saving"	Thirteen-page analysis of recent developments in personal saving behavior. Study's results indicate that efforts to spur business capital formation must treat incentives to save and invest on a broader front than personal saving. Eight tables, two graphs.	Federal Reserve Bulletin August 1980 p. 116
"The Reshaping of Corporate Financial Services"	The current turmoil in the world's financial markets will radically alter the nature of financial services offered to corporations, says the author of this nine-page article. He foresees a complete breakdown of boundaries, with no business safe from competition and a greater variety of services offered.	Harvard Business Review Sept.-Oct. 1980 p. 134
"The Selective Recession"	Brief article criticizing broadbased federal antirecession programs which aim at problems currently nonexistent in large parts of the country. Includes table of unemployment rates for all 50 states.	Forbes September 15, 1980 p. 90
"The World Economy in 1981"	Annual analysis of more than 300 forecasts for the major economies in 1980 and 1981. Summarized, the prediction is for a sharp increase in world unemployment, matched by a sharp fall in world inflation.	Euromoney October 1980 p. 262

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ITEM	DESCRIPTION	SOURCE
"The Least-Heralded Bull Market in History"	Measured by the Wilshire Index of 5,000 common stocks, the market is up 20% -- nearly $200 billion -- this year. Chart compares the DJIA and the Wilshire Index for the last 10 years.	Forbes October 13, 1980 p. 37
"Staff Report on the Securities Industry in 1979"	Third in a series of annual reports on the securities industry. Focuses on the profitability and financial structure of the industry. 117-page body plus 80 appendices.	Securities and Exchange Commission September 1980
"Commercial Bank Eligibility to Underwrite Municipal Revenue Issues and the Cost of Borrowing: Additional Evidence for 1979"	Updating their earlier study (based on 1973-1979 data), Bierwag et al find no empirical evidence that commercial bank eligibility lowered the interest cost of new municipal revenue bond issues sold in 1979.	Center for Capital Market Research September 1980
"Stabilization Policy Ten Years After"	Comprehensive overview of stabilization policy and theory against the background of the disappointing economic performance in the 1970's.	Brookings Papers on Economic Activity 1980

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